In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1366

GILES LOWERY STOCKYARDS, INC. D/B/A LUFKIN LIVESTOCK EXCHANGE,

Petitioner,

vs.

THE U. S. DEPARTMENT OF AGRICULTURE AND THE PACKERS AND STOCKYARDS—AMS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Reference Note:

As of January 1, 1978, pursuant to an internal reorganization of the U. S. Department of Agriculture, the Packers and Stockyards Administration became a division of the Agricultural Marketing Service branch of the Department of Agriculture. Hence, Petitioner refers to the Packers and Stockyards—AMS, instead of the Packers and Stockyards Administration.

Petitioner will additionally refer to the Packers and Stockyards—AMS as "Agency."

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit, pertaining to this cause, is reported at 565 F.2d 321 (C.A.—5th 1977). It is submitted in Appendix "A".

The opinion of the Judicial Officer of the U. S. Department of Agriculture, pertaining to this cause, is reported at 35 A.D. (Agriculture Decisions) 267 (1976). It is submitted in Appendix "B".

The opinion of the Administrative Law Judge of the U. S. Department of Agriculture, pertaining to this cause, was not reported. It is submitted, too, in Appendix "C".

JURISDICTION

Dates of Decision and Judgment:

The decision and judgment of the U. S. Court of Appeals for the Fifth Circuit was issued December 27, 1977.

The Petitioner did not seek a rehearing of its cause in the Court of Appeals.

Statutory Basis:

This cause originated as an administrative law proceeding initiated by an agency of the United States Government. It reached the Fifth Circuit for the U. S. Court of Appeals by virtue of the jurisdiction conferred in 28 U.S.C. 2342 (2). The Supreme Court has jurisdiction to review a decision of the U. S. Court of Appeals by granting

Writ of Certiorari, 28 U.S.C. 1254 (1), 2350; and Rule 19 (1), Revised Rules of the Supreme Court of the United States of America.

Statement:

In addition, Petitioner points out that essentially the same question raised in this Petition is being brought to this Court's attention in a Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit in a cause styled:

CENTRAL ARKANSAS AUCTION SALE, INC.; MAJOR LEWIS, D/B/A MAJOR LEWIS LIVESTOCK AUCTION SALES; BILL RICE AND LOIS RICE, D/B/A CLEBURNE COUNTY LIVESTOCK AUCTION SALE; AND TRAVIS McGEE, D/B/A ATKINS LIVESTOCK AUCTION,
Petitioners,

vs.

THE U. S. DEPARTMENT OF AGRICULTURE
AND
THE PACKERS AND STOCKYARDS—AMS,
Respondents,

from a decision issued February 10, 1978, No. 77-1452, *Central Arkansas Auction Sale, Inc.* v. *Bob Bergland,* and reported at ..... F.2d ..... (C.A.—8th 1978) (not reported as of this writing). This cause involves quite similar facts and utilizes a good deal of the Decision and Order of the Judicial Officer, Appendix "B", of the *Giles Lowery* case.

QUESTIONS PRESENTED

1. CAN THE AGENCY SEEK IN 1974 TO "STAMP WITH APPROVAL", THROUGH AD HOC LITIGATION, A METHODOLOGY, ITS RATE ANALYSIS, WHICH IT HAD FORMULATED, ADOPTED, AND APPLIED SINCE AT LEAST 1970, BUT WHICH IT HAD NEVER ANNOUNCED TO THOSE TO WHOM IT APPLIED ITS RATE ANALYSIS?
2. IS THE DECISION AND ORDER OF THE JUDICIAL OFFICER DEFECTIVE FOR ITS LACK OF REFERENCE TO ASCERTAINABLE STANDARDS?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are:

The Packers and Stockyards Act, 1921, 7 U.S.C. 181 *et seq.* and related regulations found at 9 CFR Chapter 2, and more specifically

7 U.S.C. 201

7 U.S.C. 202

7 U.S.C. 206

7 U.S.C. 207

9 CFR 203.8

The Administrative Procedure Act, 5 U.S.C. 551 *et seq.*, and more specifically

5 U.S.C. 552 (before amended on November 21, 1974, with an effective date ninety days thereafter)

5 U.S.C. 553

The specific statutes are identified and submitted as Appendix "D".

STATEMENT OF THE CASE

This case arises under 7 U.S.C. 181, *et seq.*, Packers and Stockyards Act of 1921, hereinafter referred to as the Act. Appellant, Giles Lowery Stockyards, Inc. d/b/a Lufkin Livestock Exchange, was a corporation with a place of business at Lufkin, Texas. Appellant was engaged in the business of conducting the Lufkin Livestock Exchange, a posted stockyard under the Act; was engaged in selling livestock on a commission basis at the stockyard; and was registered with the Secretary of Agriculture as a market agency to sell livestock in commerce, 7 U.S.C. 201, 202, Appendix "D" pages A133-A134.

The present appeal began with the filing of a complaint, order of suspension and notice of hearing (hereinafter referred to as complaint), on April 13, 1973. The complaint, P&S Docket No. 4782, was filed by the Administrator, Packers and Stockyards Administration (now Packers and Stockyards—AMS) (hereinafter referred to as the Agency), United States Department of Agriculture (hereinafter referred to as the Department), as agent and designate of the Secretary of Agriculture. The basis for the complaint is found in Section 207 (e) of the Act, Appendix "D" pages A135-A136.

The complaint was issued by the Agency because: On March 23, 1973, appellant filed with the Agency a new tariff (Tariff No. IV), which was to go into effect April 16, 1973, and which would have assessed greater rates and charges for stockyard services than the tariff (Tariff No. III) then on file and in effect. The Agency concluded that a further rate increase would be unreasonable and the aforementioned complaint was issued.

The Agency suspended the ultilization of Tariff No. IV by appellant for thirty days and then again for a second thirty days by publication of the complaint in the Federal Register on May 9, 1973 (38 F.R. 12143), and then again on May 23, 1973 (38 F.R. 13590). Thereafter, Tariff No. IV became effective.

An oral hearing was conducted before Chief Administrative Law Judge John A. Campbell on June 25 and 26, 1974, in Lufkin, Texas. Robert Flournoy, Esquire, of Lufkin, Texas, represented appellant, and Thomas C. Heinz, Esquire, Office of the General Counsel, United States Department of Agriculture, Washington, D.C., represented the Agency. The purpose of the hearing was to determine whether the schedule of rates and charges as set forth in appellant's Tariff No. IV were "just, reasonable, and nondiscriminatory," per Section 206 of the Act, Appendix "D" page A134.

Chief Judge Campbell filed an Initial Decision and Proposed Order on August 25, 1975, in which he sustained the Agency's position to all of the issues, and concluded that the rates and charges proposed by the Agency in the administrative proceeding, which are lower than those charged by appellant in its Tariff No. IV, "are reasonable and non-discriminatory, and are the rates and charges which appellant should assess for its services and the use of its facilities", Initial Decision, pp 35-36, Appendix "C" pages A129, A130.

On October 10, 1975, the appellant appealed the Initial Decision and Proposed Order to the Judicial Officer. Final administrative authority to decide rate cases under the Packers and Stockyards Act has been delegated to the Judicial Officer 7 U.S.C. 450c-450g. Oral argument before the Judicial Officer was heard on November 21, 1975.

A tentative Decision and Order was filed February 13, 1976.

The Decision and Order of the Judicial Officer (hereinafter referred to as the Decision and Order), was entered March 26, 1976, Appendix "B".

The sequence of events can be summarized as:

1. Petitioner sought a tariff increase; e.g. Agency acceptance of its Tariff IV.

2. The Agency issued its complaint against the Petitioner.

3. The Agency applied its rate analysis to the data derived from an audit of the Petitioner's books and records.

4. The Agency calculated a reasonable revenue requirement for Petitioner's business for a base period by an application of its rate analysis to Petitioner's audited data.

5. The Agency looks at Petitioner's present and/or former tariff.

6. The Agency declared Petitioner's tariff "unjust and unreasonable". (Presumably Tariff No. IV. It must be remembered that while the Agency directed its complaint against Tariff IV, it was Tariff III that had been in effect during the audited based period. Hence, it was Tariff III that had generated the revenues to Petitioner's business during that same period.)

7. The Agency prescribed a tariff for Petitioner's business, Appendix "B" pages A98-A99.[1]

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1. 7 U.S.C. 211 states: Whenever after full hearing upon a complaint made as provided in Section 309, or after full hearing under an order for investigation and hearing made by the Secre-

(Continued on following page)

Reference Note:

A tariff is a schedule of rates and charges which a marketing business subject to the Packers and Stockyards Act, 1921, can assess a consignor who sells his livestock through the marketing business.

A percentage tariff, or a value-based tariff, is one in which the charges to the consignor are based on the amount or value for which the consignor's livestock was sold.

A per-head tariff is one in which the charges to the consignor are based on a flat-charge per head of livestock sold. Appendix "B" pages A98-A99 is an example.

The Agency's rate analysis or rate methodology can be found briefly outlined in Appendix "B", pages A22-A24.

Footnote continued—

tary on his own initiative, either in extension of any pending complaint or without any complaint whatever, the Secretary is of the opinion that any rate, charge, regulation or practice of a stockyard owner or market agency, for or in connection with the furnishing of stockyard services, is or will be unjust, unreasonable, or discriminatory, the Secretary—

(a) May determine and prescribe what will be the just and reasonable rate or charge, or rates or charges, to be thereafter in such case observed as both the maximum and minimum to be charged, and what regulation or practice is or will be just, reasonable and nondiscriminatory to be thereafter followed; and

(b) May make an order that such owner or operator (1) shall cease and desist from such violation to the extent to which the Secretary finds that it does or will exist; (2) shall not thereafter publish, demand, or collect any rate or charge for the furnishing of stockyard services more or less than the rate or charge so prescribed; and (3) shall conform to and observe the regulation or practice so prescribed.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

Certiorari should be granted for a thorough consideration of the questions presented for three significant reasons:

1. The questions were not adequately considered in the forums below.

2. The consideration given these questions below was not in accord with existing precedents and statutory requirements.

3. The questions presented deal with important aspects of administrative law.

Introduction

Further perspective with regard to the questions presented is gained from:

1. The first question could be framed as: WHETHER THE AGENCY WAS REQUIRED, THROUGH PROPER NOTIFICATION AND PUBLICATION PROCEDURES, TO AFFORD THE PETITIONER THE OPPORTUNITY TO CONFORM TO AND OPERATE ITS BUSINESS IN LIGHT OF THE METHODOLOGY AND STANDARDS BY WHICH THE AGENCY VIEWED AND APPRAISED PETITIONER'S BUSINESS OPERATIONS FOR RATE REGULATION PURPOSES?

2. The Decision and Order begins, Appendix "B" page A16:

> "On March 28, 1973, respondent filed with complainant a new tariff (Tariff No. IV), which was to go into effect on April 16, 1973, and which would have assessed

greater rates and charges for auction market services than the tariff (Tariff No. III) then on file and in effect. Tariff No. III, which had been in effect since September 4, 1972, was accepted for filing by complainant on the basis of financial information contained in respondent's annual report[2] to complainant for the fiscal year ending June 30, 1972. Upon filing Tariff IV, respondent furnished no additional information in support of the increase in the rates and charges. Thereafter, complainant concluded that a further rate increase would be unreasonable, . . ."

The Agency had no regulations or published guidelines relating to data or information which a registrant, such as Petitioner, is required to submit in conjunction with a request for a tariff increase.

3. The Agency's rate analysis or rate methodology had not been published or announced to those whom the Agency regulated prior to the filing of the complaint against the Petitioner on April 13, 1973.

4. The Agency's rate analysis or rate methodology had not been published or announced to those whom the Agency regulated prior to the oral hearing for this cause on June 25 and 26, 1974.

5. The Agency did provide counsel for Petitioner at the oral hearing notice of its methodology for analyzing

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2. (footnote not in Decision and Order) 9 CFR 201.97 states: "Every packer, stockyard owner, market agency, dealer (except a packer buyer registered to purchase livestock for slaughter only), and licensee shall file annually with the Administration a report on prescribed forms not later than April 15 following the calendar year end or, if the records are kept on a fiscal year basis, not later than 90 days after the close of his fiscal year. The Administration on good cause shown, or on his own motion, may grant a reasonable extension of the filing date or may waive the filing of such reports in particular cases (33 F.R. 14400, Sept. 25, 1968)."

auction rates prior to the oral hearing, Appendix "A" page A11.

6. The Agency's long-standing, but unpublished and unannounced policy was to apply its rate analysis to the data of a registrant's latest annual report; see Appendix "B" page A22.

7. The Agency has published policy statements, which recognize:

(a) that Petitioner is not a public utility,

(b) that Petitioner is not a monopoly (9 CFR 203.8 (h), Appendix "D" page A140),

(c) that Petitioner is in competition with other businesses in the livestock marketing industry (CFR 203.8 (d), Appendix "D" page A138),

(d) that the Agency does not favor one marketing system over another (9 CFR 203.8 (k), Appendix "D" pages A142-A143).

I

The Agency has contended throughout that:

". . . the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency. . .", *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 203, 67 S.Ct. 1575, 1580, 91 L.Ed. 1995 (1947).

See Appendix "A" page A10. And, the thrust of the examination of the "Notice Issue" by the Court of Appeals was directed toward whether counsel for the Petitioner in the oral hearing below was given sufficient notice of the Agency's rate analysis to prepare a case, Appendix "A"

page A11, see *Hill* v. *Federal Power Commission,* 335 F.2d 355 (C.A.—5th 1964), *Port Terminal Railroad Association* v. *United States,* 551 F.2d 1336 (C.A.—5th 1977). In addition, the Court of Appeals stated, with respect to the first question and the provisions of 5 U.S.C. Section 552 (a) (1) (D),

> ". . . This publication requirement applies only to an agency's 'substantive rules of general applicability' and 'statements of general policy', and the ratemaking formula at issue here did not achieve such status until the administrative decision in this case was handed down. Prior to that time, the method was a mere position or proposal, and, as such, was available upon request under 5 U.S.C. Section 552 (a) (2) (C) . . ."

Appendix "A" page A12.

II

Both the Agency and the Court of Appeals have misplaced the import of Question 1 in the order of things. Question 1 is a threshold issue which precedes the question of notice to Petitioner's counsel prior to the administrative oral hearing.

The Agency's rate analysis or ratemaking formula or the methodology which it utilizes for its rate regulation function was formulated and adopted and applied, in whole and in part, several years before the Agency issued its complaint initiating this cause.

There is nothing in the Decision and Order, Appendix "B", which points to, or hints that, the Agency's rate analysis was a "proposition" or a "proposal". Nor, has it ever been asserted that the Agency's rate analysis, or any aspect of it, was a product of the adjudicatory process of the administrative oral hearing for this cause.

A fair reading of *SEC* v. *Chenery Corp., supra,* to place the referenced material in context, will show the unavailability of that leading decision for an affirmative answer to Question 1. That decision speaks of "problems which arise in a case which the administrative agency could not reasonably foresee . . .", "Or the Agency may not have had sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule. Or the problem may be so specialized in nature as to be impossible of capture within the boundaries of a general rule.", at 332 U.S. 194, 202, 203, 67 S.Ct. 1575, 1580. The language of that decision in context with the situation which that agency faced simply does not mean that this Agency can utilize "ad hoc litigation" to "stamp approval" on substantive policy which it had been applying to those whom it regulated, but which it had never formally announced.

III

Additional support for Petitioner's contentions with respect to Question 1 follows:

1. The Decision and Order of the Judicial Officer quite clearly shows that the Agency's methodology was formulated and adopted and applied by the Agency as far back as at least 1970:

(a) Bad Debt Allowance—Appendix "B" page A64:

> "For many years, the Complainant removed all bad debt expenses and made no allowance for bad debt losses. *However, in 1968 or 1969,* the complainant began making an allowance based on the stockyard industry's average bad debt experience (Tr. 169)." (Emphasis added)

(b) Allowance for Use of Land—Appendix "B" page A35:

"We recommended to the administrator, the Packers and Stockyards Administration, that we adopt a method of allowing a use for land of six cents per unit. *We adopted that in approximately (in) 1969,* as I recall, and since that date all land values of stockyards is based on six cents per unit." (Emphasis added)

(c) Rate of Return on Buildings and Equipment—Appendix "B" pages A76-A77:

"This is the only allowance under complainant's auction market rate analysis which is based on a rate return times value. *Prior to about 1969,* the allowance for land was computed by multiplying the rate of return times the value of the land, but the allowance for land is now computed on the basis of the number of animal units handled at the market, which, in this case, resulted in an allowance more than three times larger than would have been determined under the *pre-1969 formula.*" (Emphasis added)

(d) Animal Units and the Formula for Determining Owner's Compensation—Appendix "B" pages A59-A61, especially page A61:

"The concept of animal unit was devised because the costs associated with the sale of different species varies according to the species; but revenue analysis requires consistent treatment of all livestock sold at a market. The conversion formula *adopted by complainant* was supported by a statistical analysis by Mr. Everett Stoddard, an Agricultural Economist for complainant." (Tr. 274-275; see also, Comp. EX. IX. pp. 9-11, attached

to stipulation 3, filed August 9, 1974) (Emphasis added)

"The complainant's present formula for computing a working owner's allowance *was adopted in 1970,* and is reviewed yearly. Mr. Jack W. Brinckmeyer, Chief of complainant's Rate Branch, testified that the formula still provides more than adequate compensation for a market's working owner." (Tr. 207-209) (Emphasis added)

See the Decision and Order Appendix "B" pages A31-A38 for the significance of the animal unit concept as it enters into a number of calculated "allowances" in the Agency's rate analysis.

It has to be clear and inescapable from this immediate discussion that the Agency's "rate analysis" was internally a fully formulated and adopted and utilized methodology from at least 1970 onward. But, it was never published or announced to those against whom it was applied, including the Petitioner.

2. The Agency utilized this methodology in initiating the following rate hearings, based on the language of 7 U.S.C. 207 (e), Appendix "D" pages A135-A136, which are a matter of public record:

(a) March 29, 1974, P&S Docket No. 4933, In re Corona Livestock Auction, Inc.;

(b) July 8, 1975, P&S Docket No. 5151, In re C. E. Mills and E. E. Mills, d/b/a Mills Auction Market;

(c) July 18, 1975, P&S Docket No. 5157, In re Robertsdale Livestock Auction, Inc.;

(d) August 8, 1975, P&S Docket No. 5164, In re Granite City Livestock Sales.

Each of these rate hearings was initiated by the Agency prior to the initial decision of the administrative law judge from the oral hearing of this cause, e.g. prior to the "rate-making formula achieving the status of a 'substantive rule of general applicability' or a 'statement of general policy' ", if we are to believe the Fifth Circuit. However, the Judicial Officer, in addition to the cases which the Agency initiated, tells us otherwise; Appendix "B" pages A22-A23.

> "6. The method followed by complainant in analyzing respondent's Tariff IV, *which is the same method followed by complainant in analyzing all auction rates* (except that usually an audit is not made), is set forth as Exhibit X attached to Stipulation 3 filed August 9, 1974 (see Tr. 10-11, 145-146; Comp. Ex. 1)." (Emphasis added)

Can there by any doubt that the Agency is applying a methodology already formulated and adopted internally?

3. In addition to the erroneous consideration of the rate analysis vis-a-vis 5 U.S.C. 552, the Court of Appeals failed to address the Agency's rate analysis or rate methodology in terms of its substantial impact and general applicability, not only to the Petitioner, but to others in the industry similarly situated, and the provisions of 5 U.S.C. 553, Appendix "D" pages A145, A146, *National Motor Freight Traffic Ass'n* v. *United States*, 268 F.Supp. 90 (D.C. D.C. 1967), affirmed 393 U.S. 18, 89 S.Ct. 49, 21 L.Ed.2d 19 (1968), *Pharmaceutical Manufacturers Ass'n* v. *Finch*, 307 F.Supp. 858 (D.C. D. Dela. 1970). Certainly, there can be no doubt that the regulation of revenues which a business can receive has a substantial impact on its private rights and obligations. Elementary fairness should require that reasonable opportunity be given for

submission of views by those materially affected, *Brokers-Dealers Trade Ass'n* v. *SEC*, 442 F.2d 132, 144 (C.A.—D.C. 1971), cert. den. 404 U.S. 828, 92 S.Ct. 63, 30 L.Ed.2d 57 (1971).

4. Additional support for a thorough consideration of Petitioner's first question is found by noticing:

(a) That in 1958 Congress amended the Packers and Stockyards Act to include Petitioner, among some 2,000 other businesses such as Petitioner's, as subject to the Act, Appendix "B" pages A50-A54.

(b) That the Agency, in the oral hearing below, was seeking a declaration that all value-based tariffs were illegal, Appendix "B" page A94, e.g. contra to the language "just, reasonable, and nondiscriminatory" of 7 U.S.C. 206, Appendix "D" page A134. This aspect becomes highlighted when the Agency again turned to "ad hoc litigation" and held a rate hearing for the four (4) marketing businesses from Arkansas, whose Petition For Writ Of Certiorari To The Eighth Circuit is now before this Court, as noted earlier, and all of whom had percentage (value-based) tariffs.

(c) That at the time of the oral hearing below, some 1200 businesses, such as Petitioner's, as registrants under and subject to the Packers and Stockyards Act, 1921, utilized some form of a value-based tariff, Appendix "B" page A93, and such tariffs had been utilized within the industry without challenge from the Agency for some 15 years.

Hence, there is a close and direct analogy to *N.L.R.B.* v. *Majestic Weaving Co.*, 355 F.2d 854 (C.A.—2nd 1966).

IV

Petitioner points to a lack of ascertainable standards as a fatal defect in the Decision and Order of the Judicial Officer, *Question 2*. A brief analysis will show the defects.

First, the Agency must find a way to declare the respective tariffs of each Petitioner "unjust and unreasonable", 7 U.S.C. 211, footnote 1, *supra*. Then, secondly, the Agency can prescribe its own tariff.

The manner of getting to an "unjust and unreasonable" tariff is to first apply the rate analysis to calculate a reasonable revenue requirement for a base period.

The revenues of the marketing business are compared to the reasonable revenue requirement. If the revenues do, or are projected to, exceed the reasonable revenue requirement, the tariff generating such revenues is deemed "unjust and unreasonable", and the Agency goes on to prescribe a tariff. This happened in the instant situation. Yet, the Agency can turn right around and prescribe a tariff which also goes over the reasonable revenue requirement, Appendix "B" pages A37-A38.

> "27. The complainant determined that the current revenue received by the respondent during the base period exceeded its reasonable revenue requirements by $29,350.83 (Fig. 1, line 36), *i.e.*, the difference between the respondent's total reasonable revenue requirements during the base period (Fig. 1, line 34), and the respondent's total revenue received during the base period (Fig. 1, line 35).
>
> "Accordingly, the complainant proposed a tariff (Com. Ex. 8) which would, if applied to the livestock receipts at respondent's auction market during the base period, *produce several thousand dollars more than the reasonable revenue requirements* of $184,824.58 (Tr. 58-59; Comp. Ex. 8) . . ." (Emphasis added)

Of what merit is the rate analysis if it can be exceeded? Where is the standard that tells us the relative importance of the rate analysis vis-a-vis the possible methods by which a business could receive revenues in excess of the reasonable revenue requirement and still be deemed to have a tariff which was "just and reasonable"? There are no such standards.

The shadow over all of this cause, and argument, is that the Petitioner never ever had a chance to operate his business with a knowledge of the Agency's rate analysis.

The Agency has the requirement to formulate and apply its rate analysis and then to be the judge of how the application of its rate analysis is to be interpreted, which it has done without prior notice of any ascertainable standards to those affected. Petitioner does not believe that such Agency action can stand in harmony with the provision of the Administrative Procedure Act, as well as our elementary concepts of due process and fairness. Without notice of either the substantive policy or its interpretation, the Petitioner has been subject to "secret law".

CONCLUSION

From the above discussion it is quite evident that the questions presented did not receive adequate consideration in the forums below. And, the questions presented deal with important aspects of administrative law with serious implications to those subject to this Agency's regulation, as well as agency regulation in general. While it may at this time be academic, one cannot address this cause in a straightforward manner without posing, at least to himself, the thought: "Just maybe, if the Petitioner had been permitted to conduct his business in light of the Agency's views on rate regulation, the complaint and oral hearing below would not have been necessary."

Respectfully submitted,

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APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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APPENDIX A

565 F.2d 321 (C.A. 5th 1977)

GILES LOWERY STOCKYARDS, INC.
d/b/a Lufkin Livestock
Exchange, Petitioner,

v.

DEPARTMENT OF AGRICULTURE,
Respondent.

No. 76-2462.

United States Court of Appeals,
Fifth Circuit.

Dec. 27, 1977.

Dec. 27, 1977.

Appeal was taken from order of Department of Agriculture establishing rates and charges for operator of livestock auction market. The Court of Appeals, Thornberry, Circuit Judge, held that: (1) rate of return of slightly more than 11 percent on land, equipment, buildings and working capital was not unreasonably low; (2) the same method is not required to be used in computing rates for auction stockyard as is used for terminal stockyards; (3) rate-making method used was not infirm because it was not proposed and adopted in a rule-making context; (4) even if publication was required, the operator had actual notice of the rate-making method and (5) it was permissible to use nationwide allowances or averages of auction markets in fixing petitioner's rates.

Affirmed.

1. Administrative Law and Procedure (Key) 749

Absent a showing to the contrary, agency officials are assumed capable of judging a controversy fairly and without bias or prejudice.

2. Trade Regulation (Key) 871

No rate is reasonable that is confiscatory. U.S.C.A. Const. Amend. 5.

3. Trade Regulation (Key) 871

In establishing rates and charges for livestock auction markets, no single method of ratemaking is required. Packers and Stockyards Act, 1921, §§ 305, 310, 7 U.S.C.A. §§ 206, 211.

4. Administrative Law and Procedure (Key) 324

When Congress has directed that rates be regulated but has not specified a method for doing so, the agency has discretion in devising a particular scheme. Packers and Stockyards Act, 1921, § 305, 7 U.S.C.A. § 206.

5. Trade Regulation (Key) 871

If the total effect of a rate order cannot be said to be unjust and unreasonable, judicial inquiry is at an end, and it is unimportant that the method employed to reach such results contained infirmities. Packers and Stockyards Act, 1921, § 305, 7 U.S.C.A. § 206.

6. Trade Regulation (Key) 871

In devising a rate-making scheme, the regulatory agency can take into account the peculiar characteristics of a particular industry and can choose among various competing theories. Packers and Stockyards Act, 1921, § 305, 7 U.S.C.A. § 206.

7. Trade Regulation (Key) 871

A regulated industry is not entitled to realize a particular rate of return; interests of the consuming public are also to be considered in establishing rates. U.S.C.A. Const. Amend. 5; Packers and Stockyards Act, 1921, § 305, 7 U.S.C.A. § 206.

8. Trade Regulation (Key) 871

If results reached by Department of Agriculture in establishing rates and charges for livestock auction market was reasonable, judicial inquiry would be at an end and there would be no need to examine the rate-making scheme itself. Packers and Stockyards Act, 1921, §§ 305, 310, 7 U.S.C.A. §§ 206, 211.

9. Constitutional Law (Key) 298(1)

A party attacking a prescribed rate schedule bears the heavy burden of showing by clear and convincing proof that the rates are unreasonably low; absent such proof the courts will not find a Fifth Amendment violation. U.S.C.A. Const. Amend. 5.

10. Trade Regulation (Key) 871

In establishing rates and charges for livestock auction market, it was not unreasonable to fix a rate of return of slightly more than 11 percent on land, equipment, buildings and working capital. Packers and Stockyards Act, 1921, §§ 305, 310, 7 U.S.C.A. §§ 206, 211; U.S.C.A. Const. Amend. 5.

11. Trade Regulation (Key) 871

In establishing rates and charges for auction stockyards the Department of Agriculture is not required to utilize the same method as used in computing rates for terminal stockyards, i. e., the rate base/rate of return

formula; differences between the two types of operations can be considered in determining a rate formula. Packers and Stockyards Act, 1921, §§ 305, 310, 7 U.S.C.A. §§ 206, 211.

12. Administrative Law and Procedure (Key) 324

Choice between rulemaking and an ad hoc proceeding to determine policy lies within the discretion of the administrative agency. 5 U.S.C.A. § 552(a)(1)(D).

13. Administrative Law and Procedure (Key) 389

An agency may announce new principles or policies in an adjudicatory proceeding and is not required to resort to rulemaking, although it may do so. 5 U.S.C.A. § 552 (a)(1)(D).

14. Public Service Commissions (Key) 12

A regulated industry is to be sufficiently apprised of the standards that will be applied to determine a reasonable rate in order that it may adequately prepare its case.

15. Trade Regulation (Key) 871

Method of computation used in fixing rates for livestock auction market was not required to be first proposed and adopted by Department of Agriculture in a rule-making context; Department could adopt a method of computation by adjudication as well as by rule-making. Packers and Stockyards Act, 1921, §§ 305, 310, 7 U.S.C.A. §§ 206, 211.

16. Trade Regulation (Key) 871

Operator of livestock auction market was sufficiently apprised of method of computation intended to be used in establishing rates and charges where prior to administrative hearing operator was presented with a 15-page document outlining method used to handle auction rate as

well as a financial analysis of the operator for rate purposes; fact that particular rate-making method used was not formally adopted until judicial officer's decision was irrelevant as was fact that operator, relying on cases involving terminal stockyards, chose to build its case on rate base principle. Packers and Stockyards Act, 1921, §§ 305, 310, 7 U.S.C.A. §§ 206, 211; 5 U.S.C.A. § 552(a)(1)(D), (a)(2)(C).

17. Trade Regulation (Key) 871

Since rate-making formula used in establishing charges for livestock auction market did not achieve status of a substantive rule of general applicability until administrative decision in instant proceeding was handed down, prior publication in Federal Register was not required; even if publication were required, the operator could not be heard to complain since prior to administrative hearing it had actual knowledge of the rate-making method proposed to be used. Packers and Stockyards Act, 1921, §§ 305, 310, 7 U.S.C.A. §§ 206, 211; 5 U.S.C.A. § 552(a)(1)(D), (a)(2)(C).

18. Administrative Law and Procedure (Key) 749

A presumption of validity is accorded administrative bodies acting within their sphere of expertise.

19. Public Service Commissions (Key) 7.4, 32

An agency has considerable discretion in determining just and reasonable rates; a court cannot substitute its judgment for that of the agency.

20. Trade Regulation (Key) 871

Use of nationwide industry studies, rather than actual figures provided by livestock auctioneer, was within discretion of the Department of Agriculture in establishing

rates and charges for the auctioneer; the "just and reasonable" principle does not require that the cost of each company be ascertained and its rates fixed with respect to its own costs. Packers and Stockyards Act, 1921, §§ 305, 310, 7 U.S.C.A. §§ 206, 211.

Petition for Review of an Order of the Department of Agriculture (Texas Case).

Before THORNBERRY, Circuit Judge, SKELTON, Senior Judge*, and HILL, Circuit Judge.

THORNBERRY, Circuit Judge:

This is an appeal from an Order of the Department of Agriculture establishing rates and charges for the petitioner, a corporation that operates the Lufkin Livestock Exchange at Lufkin, Texas. The Exchange is an "auction market" at which producers' livestock is sold on a commission basis.

The case arose when petitioner sought permission to increase its charges to farmers and ranchers for selling their livestock. The Packers and Stockyards Act requires that all rates or charges made by a stockyard owner or operator be "just, reasonable, and nondiscriminatory." 7 U.S.C. § 206.[1] The Act also provides that whenever,

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*Senior Judge of the United States Court of Claims, sitting by designation.

1. There is no doubt that the Act applies to petitioner's operation. In 1958, following extensive hearings, Congress extended the Act's regulatory provisions to auction stockyards, regardless of size. See Senate Rep. No. 1048, 85th Congress, 1st Sess. (1958). There are approximately 2,000 such stockyards operating today, and this is apparently the first case involving ratemaking for these "auction markets." As the judicial officer noted in his decision, this case "will serve as a guide for the Department's rate policy. . . ." 35 A.D. at 282.

after full hearing, the Secretary of Agriculture determines that any rate or charge is or will be unjust, unreasonable, or discriminatory, the Secretary may determine and prescribe reasonable rates or charges. 7 U.S.C. § 211. Final administrative authority to decide rate cases under the Act has been delegated to the Department of Agriculture's judicial officer, who in this case denied the requested rates and instead adopted a rate schedule proposed by the Department. *Giles Lowery Stockyards*, 35 A.D. 267 (1976).

[1] This appeal followed, and petitioner and the Livestock Marketing Association, *amicus curiae*, raise three broad issues before this court: (1) whether the ratemaking scheme employed by the Department is confiscatory in violation of the fifth amendment; (2) whether petitioner had adequate notice of the procedures to be utilized in the ratemaking process; and (3) whether substantial evidence on the record as a whole supports the administrative decision.[2] For the reasons stated below, we affirm.

I. Ratemaking Method

Petitioner contends that the ratemaking scheme used by the Department does not insure a reasonable rate of return and complains that the method is deficient because it does not consider petitioner's investment in the business.

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2. At oral argument petitioner also pointed to possible bias on the part of the judicial officer who issued the administrative decision. Petitioner did not raise this issue in its brief and offered nothing in support of its charge of bias. It is sufficient for us to note that absent a showing to the contrary, agency officials are assumed capable of judging a controversy fairly and without bias or prejudice. *Withrow* v. *Larkin*, 421 U.S. 35, 55, 95 S.Ct. 1456, 43 L.Ed.2d 712 (1975). *See also Hortonville Joint School Dist.* v. *Hortonville Educ. Ass'n*, 426 U.S. 482, 96 S.Ct. 2308, 49 L.Ed.2d 1 (1976).

[2, 3] It is elementary that no rate is reasonable that is confiscatory. *See Railroad Commission Cases,* 116 U.S. 307, 6 S.Ct. 334, 388, 29 L.Ed. 636 (1886). However, there exists a "zone of reasonableness within which [an agency] is free to fix a rate varying in amount and higher than a confiscatory rate . . ." *FPC* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 585, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942). Moreover, no single method of ratemaking is required; rather, "it is the result reached, not the method employed, which is controlling. . . . It is not theory but the impact of the rate order which counts." *FPC* v. *Hope Natural Gas Co.,* 320 U.S. 591, 602, 64 S.Ct. 281, 287, 88 L.Ed. 333 (1944). *Accord: Wisconsin* v. *FPC,* 373 U.S. 294, 309, 83 S.Ct. 1266, 10 L.Ed.2d 357 (1963); *FPC* v. *Texaco, Inc.,* 417 U.S. 380, 387-88, 94 S.Ct. 2315, 41 L.Ed.2d 141 (1974).

[4-7] When Congress has directed that rates be regulated but has not specified a method for doing so, the agency has discretion in devising a particular scheme. *Permian Basin Rate Cases,* 390 U.S. 747, 776-77, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968); *Wisconsin* v. *FPC, supra,* 373 U.S. at 309, 83 S.Ct. 1266. If the total effect of a rate order cannot be said to be unjust and unreasonable, judicial inquiry is at an end, and it is unimportant that the method employed to reach that result contained infirmities. *FPC* v. *Hope Natural Gas Co., supra,* 320 U.S. at 602, 64 S.Ct. 281; *Alabama-Tennessee Natural Gas Co.* v. *FPC,* 359 F.2d 318, 331 (5 Cir.), *cert. denied,* 385 U.S. 847, 87 S.Ct. 69, 17 L.Ed.2d 78 (1966). In devising a ratemaking scheme, a regulatory agency can take into account the peculiar characteristics of a particular industry and can choose among various competing theories. *Alabama-Tennessee Natural Gas Co.* v. *FPC, supra,* 359 F.2d at 335. Finally, a regulated industry is not entitled, as a matter of right, to realize a particular rate of return, and the

interests of the consuming public are also to be considered in establishing rates. *Covington & Lexington Turnpike Co.* v. *Sandford,* 164 U.S. 578, 596, 17 S.Ct. 198, 41 L.Ed. 560 (1896); *FPC* v. *Natural Gas Pipeline Co., supra,* 315 U.S. at 606-07, 62 S.Ct. 736 (Black, J., concurring).

[8-10] These principles make clear that this court must first consider whether the result reached by the Department in the instant case is reasonable. If so, our inquiry is at an end and there is no need to examine the ratemaking scheme itself.[3] A party attacking a prescribed rate schedule must show with clear and convincing proof that the rates are unreasonably low. In the absence of such proof, the courts will not find a fifth amendment violation. *American Toll Bridge Co.* v. *Railroad Comm'n,* 307 U.S. 486, 494-95, 59 S.Ct. 948, 83 L.Ed. 1414 (1939); *FPC* v. *Hope Natural Gas Co., supra,* 320 U.S. at 602, 64 S.Ct. 281. Petitioner has failed to carry this rather heavy burden.[4]

[11] Finally, petitioner urges that the same method must be used for computing rates for auction stockyards as for terminal stockyards, *i. e.,* a rate base/rate of return

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3. Petitioner focuses its attack on the ratemaking formula, arguing that the Department should have utilized a rate base and rate of return formula. Petitioner specifically complains of the Department's "unit allowance" concept, which takes nationwide averages regarding expenses and allocates a certain amount to each animal sold. This approach is also referred to as a "per-head-weight" schedule and is used by approximately 800 of the nation's 2,000 auction markets.

4. The rates approved by the Department will produce nearly $185,000 annually, this providing petitioner with approximately $43,600 more than reasonable expenses and depreciation. Of this amount, about $6,500 was allowed as a reasonable return on land, equipment, buildings, and working capital. For purposes of comparison, the judicial officer computed a "rate base" using accepted public utility principles and arrived at a figure of approximately $58,300, of which $6,500 would be slightly more than 11 per cent. That rate of return is considerably higher than the 8 per cent frequently used in other regulated industries.

formula. *See generally Denver Union Stock Yard Co.* v. *United States,* 304 U.S. 470, 58 S.Ct. 990, 82 L.Ed. 1469 (1938); *St. Joseph Stock Yards Co.* v. *United States,* 298 U.S. 38, 56 S.Ct. 720, 80 L.Ed. 1033 (1936). There is a great deal of difference between the two types of operations,[5] and the Department clearly can take into account these differences in determining a rate formula to apply. *Alabama-Tennessee Natural Gas Co.* v. *FPC, supra,* 359 F.2d at 335.

II. Notice

[12, 13] Petitioner first contends that the method of computation utilized in the ratemaking proceeding should have been first proposed and adopted by the Department in a rulemaking context. However, the choice between rulemaking and an ad hoc proceeding to determine policy lies within the discretion of the administrative agency. *SEC* v. *Chenery Corp.,* 332 U.S. 194, 203, 67 S.Ct. 1575, 91 L.Ed. 1995 (1974); *Alabama-Tennessee Natural Gas Co.* v. *FPC, supra,* 359 F.2d at 343. Moreover, an agency may announce new principles in an adjudicatory proceeding and need not resort to rule-making. *NLRB* v. *Bell Aerospace So.,* 416 U.S. 267, 294, 94 S.Ct. 1757, 40

5. Terminal stockyards have been traditionally located at major railroad centers and are the "throat through which the current [of livestock] flow." *Stafford* v. *Wallace,* 258 U.S. 495, 516, 42 S.Ct. 397, 66 L.Ed. 735 (1922). Owners of a terminal stockyard provide the facilities where livestock are bought and sold, while the selling function is performed by independent market agencies. The owners' entire income thus depends upon the return allowed on their investment. Auction markets, on the other hand, are generally small operations located in cattle-producing areas. Most are owner operated with the owner performing the sales function. In this respect, the owner-operator is in much the same position as the independent market agency at a terminal stockyard. Finally, terminal stockyards ordinarily operate in monopolistic settings, while it is not unusual to find several auction markets within a few miles of one another. The judicial officer compared terminal stockyards to such "traditional" public utilities as railroads and electric companies, and likened auction markets to owner-operated taxicabs. 35 A.D. at 283.

L.Ed.2d 134 (1974). *See also Port Terminal R.R. Ass'n* v. *United States,* 551 F.2d 1336, 1341-42 (5 Cir. 1977).

[14-16] Petitioner, however, urges that it was prejudiced because the Department failed to make known, prior to the hearing, the method of computation it intended to utilize. Petitioner relies heavily on *Hill* v. *FPC,* 335 F.2d 355 (5 Cir. 1964), which requires that a public utility be sufficiently apprised of the standards that will be applied to determine a reasonable rate in order that the utility may adequately prepare its case. *See also Port Terminal R.R. Ass'n* v. *United States, supra,* 551 F.2d at 1342-43.

The Department informed petitioner's counsel by letter, well in advance of the hearing, of the "method used by the Packers and Stockyards Administration to analyze auction rates." Enclosed with the letter was a 15-page document outlining that method, as well as a financial analysis of Lufkin Livestock for rate purposes. *See* Exhibit 1, Record (vol. 1); Exhibit 10, Record (vol. 4). Petitioner was thus aware of the ratemaking approach, was aware that the Department planned to apply it in this case, and was presented with opportunity to build a case around the method or attack its application. The case is unlike both *Hill* and *Port Terminal R.R. Ass'n, supra,* in which the aggrieved parties had no such notice or opportunity.

The fact that this particular ratemaking method was not formally adopted by the Department until the judicial officer's decision in this particular case is irrelevant, since an agency can adopt such policies via adjudication as well as by rulemaking. The critical inquiry is whether petitioner had notice of the method so that it could prepare a case, and there is no doubt that petitioner had such notice. Nor is it relevant that petitioner, relying on cases

involving terminal stockyards, chose to build its case on rate base principles, because petitioner had notice that another formula was to be utilized.

[17] Petitioner also advances a Freedom of Information Act argument to the effect that the Department was required to publish its ratemaking method. *See* 5 U.S.C. § 552(a)(1)(D).[6] This publication requirement applies only to an agency's "substantive rules of general applicability" and "statements of general policy," and the ratemaking formula at issue here did not achieve such status until the administrative decision in this case was handed down. Prior to that time, the method was merely a position or proposal, and, as such, was available upon request under 5 U.S.C. § 552(a)(2)(C).[7] That portion of the FOIA, however, does not mandate publication,[8] and petitioner apparently made no request for the information. Moreover, we re-emphasize that petitioner had actual notice of the ratemaking method, and even if publication were required here, actual knowledge or notice of agency policy precludes reliance on the agency's failure to comply with the FOIA's publication requirement. *Whelan* v. *Brinegar*, 538 F.2d 924, 927 (2d Cir. 1976); *Kessler* v. *FCC*, 117 U.S.App.D.C. 130, 147, 326 F.2d 673, 690 (1963).

6. This subsection provides:

> Each agency shall separately state and currently publish in the Federal Register for the guidance of the public—. . . substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency.

7. This subsection provides:

> Each agency, in accordance with published rules, shall make available for public inspection and copying—. . . administrative staff manuals and instructions to staff that affect a member of the public . . .

8. In fact, it is unclear whether the method must *now* be published in the Federal Register. Professor Davis has suggested that some, but not all, adjudicatory opinions must be published. K. Davis, Administrative Law Treatise § 3A.7 (Supp. 1970). The Attorney General's *Memorandum on the Public Information Section of the Administrative Procedure Act* (1967) takes the position that no statement of policy in an adjudicatory opinion need be published. Under this view, administrative "case law" is available under subsection (2)(A), which requires agencies to make available for public inspection and copying "final orders made in the adjudication of cases." *See Memorandum, supra*, at 10. As Professor Davis later pointed out, "time goes on without a clarification." K. Davis, Administrative Law of the Seventies § 3A.7, at 73 (1976). This case does not present us with the opportunity to provide any guidance in this muddled area.

III. Substantial Evidence

[18, 19] Petitioner also raises the almost-obligatory "substantial evidence" challenge: whether substantial evidence on the record as a whole supports the administrative decision. *See Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 71 S.Ct. 456, 95 L.Ed. 456 (1951). A presumption of validity is accorded to administrative bodies acting within their sphere of expertise, *ICC* v. *Jersey City*, 322 U.S. 503, 512, 64 S.Ct. 1129, 88 L.Ed. 1420 (1944), and an agency has considerable discretion in determining just and reasonable rates. *TNT Tariff Agents, Inc.* v. *ICC*, 525 F.2d 1089, 1093 (2d Cir. 1975). We cannot substitute our judgment for that of the agency, *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 416, 91 S.Ct. 814, 28 L.Ed.2d 136 (1971), and we have in the past noted that our review of the exercise of agency authority is confined "by the narrow perimeter of the substantial evidence rule." *Colonial Stores, Inc.* v. *FTC*, 450 F.2d 733, 739 (5 Cir. 1971). Applying these principles, we find no merit to petitioner's argument and conclude that the judicial officer's exhaustive 54-page opinion finding the Department's proposed rates just and reasonable is supported by substantial evidence. The agency has clearly set forth the grounds on which it acted, *Atchison, T. & S. F. R.* v. *Wichita Bd. of Trade*, 412 U.S. 800, 807, 93 S.Ct. 2367, 37 L.Ed.2d 350 (1973), and has taken a "hard look" at the issues and

problems. *Greater Boston Television Corp.* v. *FCC*, 143 U.S.App.D.C. 383, 393, 444 F.2d 841, 851 (1970).

[20] In the context of this case, a substantial evidence attack is merely another means by which petitioner can challenge the Department's ratemaking method. Indeed, petitioner emphasizes that various "allowances" based on nationwide industry studies—rather than actual figures provided by petitioner—were utilized in the rate calculations.[9] Use of such allowances or averages is clearly within the agency's discretion. The "just and reasonable" principle does not require "that the cost of each company be ascertained and its rates fixed with respect to its own costs." *FPC* v. *Texaco, Inc., supra*, 417 U.S. at 387, 94 S.Ct. at 2321. It is permissible for an agency to use average costs rather than the costs of individual utilities. *Permian Basin Area Rate Cases, supra*, 390 U.S. at 818-19, 88 S.Ct. 1344. *Southern Louisiana Area Rate Cases* v. *FPC*, 428 F.2d 407, 432 (5 Cir.), *cert. denied*, 400 U.S. 950, 91 S.Ct. 241, 27 L.Ed.2d 257 (1970). *See also Tagg Bros. & Moorhead* v. *United States*, 280 U.S. 420, 440-42, 50 S.Ct. 220, 74 L.Ed. 524 (1930). To require an agency to rely only upon figures supplied by a utility would encourage the company to inflate its actual expenses in order to obtain higher rates and to engage in imprudent business practices while secure in the knowledge that such losses would be absorbed by the consumer. *See United Gas Public Service Co.* v. *Texas*, 303 U.S. 123, 150-51, 58 S.Ct. 483, 82 L.Ed. 702 (1938) (Black, J., concurring).

The administrative decision is AFFIRMED.

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9. For example, although petitioner claimed bad debt losses of more than $4,400 during the year in question, the Department used $2,700, a figure reached by taking .03 per cent of the gross value of livestock sold during the particular year. This allowance is utilized even though an auction market experienced no bad debt losses during the year. The formula was determined after a study of the ratio between bad debts and gross sales at auction markets across the country.

APPENDIX B

(No. 16,989)

In re GILES LOWERY STOCKYARDS, INC., d/b/a LUFKIN LIVESTOCK EXCHANGE. P&S Docket No. 4782. Decided March 26, 1976.

Rate-making procedure—challenges to—Rate-making principles—applicability of

Complainant's rate-making procedure is reasonable and its rate-making principles employed herein are applicable to respondent's auction stockyard. Respondent's challenges thereto are found to be without merit.

Buildings and equipment—rate of return on

Complainant's rate of return as set forth herein is consistent with that allowed in other regulated industries and is just and reasonable.

Reasonable revenue requirements—increase

An increase in the reasonable revenue requirements does not result in a change in the proposed tariff.

Rates and charges of respondent—unjust and unreasonable—Complainant's proposed rates and charges—just, reasonable and nondiscriminatory—Complainant—Proposed Tariff IV—adoption of—Order to respondent to assess accordingly

Where the rates and charges of respondent are unjust, unreasonable and prohibited by law, and the rates and charges as proposed by complainant in its Proposed Tariff IV are just, reasonable, and nondiscriminatory, respondent is ordered to assess those rates and charges as set forth in the Order herein.

Thomas C. Heinz, for complainant.

Robert Flournoy, Lufkin, TX, for respondent.

John A. Campbell, Administrative Law Judge.

Decision by Donald A. Campbell, Judicial Officer.

DECISION AND ORDER

PRELIMINARY STATEMENT

This is a proceeding under the Packers and Stockyards Act, 1921, as amended (7 U.S.C. 181 *et seq.*), involving the rates and charges assessed by the respondent corporation for rendering auction market services at the Lufkin Livestock Exchange, Lufkin, Texas.

On March 28, 1973, respondent filed with complainant a new tariff (Tariff No. IV), which was to go into effect on April 16, 1973, and which would have assessed greater rates and charges for auction market services than the tariff (Tariff No. III) then on file and in effect. Tariff No. III, which had been in effect since September 4, 1972, was accepted for filing by complainant on the basis of financial information contained in respondent's annual report to complainant for the fiscal year ending June 30, 1972. Upon filing Tariff IV, respondent furnished no additional information in support of the increase in the rates and charges. Thereafter complainant concluded that a further rate increase would be unreasonable, and by Complaint, Order of Suspension and Notice of Hearing, filed herein on April 13, 1973, complainant suspended the operation and use of Tariff IV for a period of 30 days. The Complaint, Notice of Hearing and Order of Suspension was published in the Federal Register on May 9, 1973 (38 F.R. 12143), and among other things stated that "respondent

and all other interested parties will have a right to appear" and present relevant evidence. The suspension was subsequently extended for an additional 30 days, followed by publication in the Federal Register on May 23, 1973 (38 F.R. 13590). Thereafter, Tariff IV became effective.

An oral hearing was conducted before Chief Administrative Law Judge John A. Campbell on June 25 and 26, 1974, in Lufkin, Texas. Robert Flournoy, Esquire, of Lufkin, Texas, represented respondent, and Thomas C. Heinz, Esquire, Office of the General Counsel, United States Department of Agriculture, Washington, D.C., represented the complainant.

The parties filed Stipulation 1 on June 14, 1974; Stipulation 2 became a part of the record during the hearing; and Stipulation 3 was filed after the hearing on August 9, 1974.

Chief Judge Campbell filed an Initial Decision and Proposed Order on August 25, 1975, in which he sustained the complainant's position as to all of the issues, and concluded that the rates and charges proposed by complainant in the administrative proceeding, which are lower than those charged by respondent in its Tariff IV, "are reasonable and nondiscriminatory, and are the rates and charges which Respondent should assess for its services and the use of its facilities" (Initial Decision, pp. 35-36).

On October 10, 1975, the respondent appealed the Initial Decision and Proposed Order to the Judicial Officer. Final administrative authority to decide rate cases under the Packers and Stockyards Act has been delegated to the Judicial Officer (37 F.R. 28475; 38 F.R. 10795).[1] Oral

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1. The office of Judicial Officer is a career position established pursuant to the Act of April 4, 1940 (7 U.S.C. 450c-450g),

(Continued on following page)

argument before the Judicial Officer was heard on November 21, 1975. A tentative Decision and Order was filed February 13, 1976, virtually identical to this Decision and Order.

RELEVANT STATUTORY PROVISIONS

The Packers and Stockyards Act defines the term "stockyard" to mean "any place, establishment, or facility commonly known as stockyards, conducted, operated, or managed for profit or nonprofit as a public market for livestock producers, feeders, market agencies, and buyers, consisting of pens, or other inclosures, and their appurtenances, in which live cattle, sheep, swine, horses, mules, or goats are received, held or kept for sale or shipment in commerce" (7 U.S.C. 202(a)).[2]

After the Secretary ascertains that a stockyards comes within the statutory definition, he is required to "give notice thereof to the stockyard owners concerned, and give public notice thereof by posting copies of such notice in the stockyard, and in such other manner as he may determine" (7 U.S.C. 202(b)). Such stockyards are referred to as "posted" stockyards.

The Act defines the term "stockyard owner" to mean "any person engaged in the business of conducting or

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Footnote continued—

and Reorganization Plan No. 2 of 1953 (5 U.S.C. 1970 ed., Appendix, p. 550). The Department's first Judicial Officer held the office from 1942 to 1972. The present Judicial Officer was appointed in January 1971, having been involved with the Department's regulatory programs since 1949 (including 3 years' trial litigation; 10 years' appellate litigation relating to appeals from the decisions of the prior Judicial Officer; and 8 years as administrator of the Packers and Stockyards Act regulatory program.

2. Following the parlance of the trade, the terms "stockyard" and "stockyards" are used herein interchangeably to refer to an individual livestock market.

operating a stockyard" (7 U.S.C. 201(a)). The term "market agency" is defined as "any person engaged in the business of (1) buying or selling in commerce livestock on a commission basis or (2) furnishing stockyard services" (7 U.S.C. 201(c)).

"Stockyard services" means "services or facilities furnished at a stockyard in connection with the receiving, buying, or selling on a commission basis or otherwise, marketing, feeding, watering, holding, delivery, shipment, weighing, or handling in commerce, of livestock" (7 U.S.C. 201(b)).

Section 304 of the Act states that "[a]ll stockyard services furnished pursuant to reasonable request made to a stockyard owner or market agency at such stockyard shall be reasonable and nondiscriminatory and stockyard services which are furnished shall not be refused on any basis that is unreasonable or unjustly discriminatory" (7 U.S.C. 205).

Section 305 of the Act provides that "[a]ll rates or charges made for any stockyard services furnished at a stockyard by a stockyard owner or market agency shall be just, reasonable, and nondiscriminatory, and any unjust, unreasonable, or discriminatory rate or charge is prohibited and declared unlawful" (7 U.S.C. 206).

Section 310 of the Act provides that whenever after full hearing the Secretary is of the opinion that any rate or charge of a stockyard owner is or will be unjust, unreasonable, or discriminatory, the Secretary may determine and prescribe what will be the just and reasonable rates or charges to be thereafter in such case observed as both the maximum and minimum to be charged (7 U.S.C. 211). Specifically, § 310 of the Act provides (7 U.S.C. 211):

Whenever after full hearing upon a complaint made as provided in section 210 of this title, or after full hearing under an order for investigation and hearing made by the Secretary on his own initiative, either in extension of any pending complaint or without any complaint whatever, the Secretary is of the opinion that any rate, charge, regulation, or practice of a stockyard owner or market agency, for or in connection with the furnishing of stockyard services, is or will be unjust, unreasonable, or discriminatory, the Secretary—

(a) May determine and prescribe what will be the just and reasonable rate or charge, or rates or charges, to be thereafter in such case observed as both the maximum and minimum to be charged, and what regulation or practice is or will be just, reasonable, and nondiscriminatory to be thereafter followed; and

(b) May make an order that such owner or operator (1) shall cease and desist from such violation to the extent to which the Secretary finds that it does or will exist; (2) shall not thereafter publish, demand, or collect any rate or charge for the furnishing of stockyard services more or less than the rate or charge so prescribed; and (3) shall conform to and observe the regulation or practice so prescribed.

Section 313 of the Act provides that orders of the Secretary prescribing rates and charges "shall take effect within such reasonable time, not less than five days, as is prescribed in the order, and shall continue in force until his further order, or for a specified period of time, according as is prescribed in the order, unless such order is suspended or modified or set aside by the Secretary or is suspended or set aside by a court of competent jurisdiction" (7 U.S.C. 214).

FINDINGS OF FACT

1. Respondent Giles Lowery Stockyards, Inc., d/b/a Lufkin Livestock Exchange, is a corporation with a place of business at Lufkin, Texas.

2. Respondent is, and at all times material herein was:

(a) engaged in the business of conducting the Lufkin Livestock Exchange, a posted stockyard under the Act;

(b) engaged in the business of selling livestock on a commission basis at the stockyard; and

(c) registered with the Secretary of Agriculture as a market agency to sell livestock in commerce.

3. Giles Lowery Stockyards, Inc., owns two stockyards, the Lufkin Livestock Exchange and the Bay City Livestock Commission. Giles Lowery is active in both stockyards. The Lufkin Livestock Exchange was posted in March 1959 and was incorporated in February 1960. Herbert Lowery then owned 98% of the shares of stock in the corporation and Giles Lowery owned 1%. In November 1968, Giles Lowery purchased the Lufkin Livestock Exchange from Herbert Lowery. In December 1968, the Giles Lowery Stockyards, Inc., became a separate corporation. Since then, Giles Lowery has been President and sole owner of Giles Lowery Stockyards, Inc. (Tr. 7-9).

4. Complainant accepted for filing (without determining the reasonableness thereof) respondent's Tariff III effective September 4, 1972, based upon respondent's annual report for the fiscal year ending June 30, 1972. Subsequently, on March 28, 1973, respondent filed proposed Tariff IV to become effective April 16, 1973, which assessed increased rates and charges for its auction market

services and which was based on the earlier June 30, 1972, annual report. Complainant concluded that the rates and charges proposed in Tariff IV were unreasonable, and suspended the operation of the tariff for a period of 60 days (Stipulation 1; Tr. 6-7, 75-78, 144-145, 151-152).

5. Complainant's original conclusion that the rates and charges proposed in Tariff IV were unreasonable was based on the fact that the proposed tariff was supported only by respondent's annual report submitted for the period ending June 30, 1972. Since the complainant did not have any current information from the respondent justifying an increase, the proposed tariff was suspended for 60 days.

Subsequently, the complainant conducted an audit of respondent's books and records for the period July 1, 1972, through June 30, 1973, which is the respondent's fiscal year. This is the "base period" used by complainant for the purposes of this rate proceeding. The complainant's present conclusion that the respondent's rates and charges proposed in Tariff IV are unreasonable is based on that audit of respondent's books and records (Tr. 6-7).

6. The method followed by the complainant in analyzing respondent's Tariff IV, which is the same method followed by complainant in analyzing all auction rates (except that usually an audit is not made), is set forth as Exhibit X attached to Stipulation 3 filed August 9, 1974 (see Tr. 10-11, 145-146; Comp. Ex. 1).

The rate analysis begins with an examination of the stockyard's cost of operation. Most of the market's expenses are presumed to be reasonable and necessary for efficient operation of the stockyards unless shown otherwise. In the present case, of the $203,846.57 shown on respondent's books and records as total expenses for the

base period, 62% thereof, or $125,764.37, were accepted by complainant as reasonable and necessary.

Any expenses which complainant determines are not properly chargeable to the stockyards are subtracted from the total expenses. Four categories of expenses which are properly chargeable to the stockyards are subtracted and later replaced by allowances which the complainant determines to be reasonable for such expenses. Such allowances may be more or less than the actual expenses of the market. The expenses replaced by allowances are as follows:

First, the compensation paid by a market to an owner for his work and for his management is removed and replaced by allowances for work and management determined by complainant's formula.

Second, interest paid by the stockyards is removed from the total expenses, and an allowance is later included for a return on working capital. Third, bad debts are excluded and replaced by an allowance based on industry averages.

Fourth, "Business Getting and Maintaining" expenses are removed and replaced by an allowance. The category of Business Getting and Maintaining expenses includes losses sustained by the market as market support activities.

After the various expense items are removed from the total expenses, the resulting figure is referred to as the "Adjusted Expenses," which totalled $125,764.37 in the present case.

To the Adjusted Expenses are added the complainant's allowances for "Compensation for Working Owners;" "Owner's Management and Interest on Working Capital;"

"Business Getting and Maintaining" expenses; and "Bad Debts." In addition, the complainant adds to the Adjusted Expenses an allowance for the return on buildings and equipment (computed at 8% of original cost, less depreciation), an allowance for the use of land in connection with the stockyards and an allowance for operating margin.

The Adjusted Expenses together with the sum of the allowances equals the "Total Reasonable Revenue Requirements" of the market.

A comparison of the Total Reasonable Revenue Requirements with the Total Revenue (Selling Commissions and Yardage) resulting from the market's tariff is the final step which shows whether the market's present rates result in Total Revenue greater than the market's Total Reasonable Revenue Requirements.

The complainant's cost and revenue analysis for the respondent's stockyards for the base period July 1, 1972, through June 30, 1973, is shown in Figure 1, which follows. The individual items on Figure 1 are discussed *seriatim* in the following Findings of Fact.

LUFKIN LIVESTOCK EXCHANGE
LUFKIN, TEXAS

COST AND REVENUE ANALYSIS FOR RATE PURPOSES AFTER AUDIT

(BASE PERIOD 7/1/72—6/30/73)

			Adjustments (Removals)		
1.	Expenses per Rate Audit				$203,846.57
2.	*LESS*:	Compensation to Owner			
3.		Salary	$14,070.00		
4.		Solicitor's Fee	6,307.29		
5.		Total Compensation		$20,377.29	
6.	*LESS*:	Interest paid	14,537.05		
7.		Bad debts	4,410.23		
8.		Pasture rent	300.00		
9.		Trucking & Hauling	9,370.78		
10.		Church contributions	70.00		
11.		Donations	461.00		
12.		Non-Auction Market Expenses	1,318.75		
13.		Total		30,467.81	
14.					
15.	*LESS*:	Business Getting & Maintaining Expenses			
16.		Advertising	2,497.34		
17.		Solicitor's Expense	500.00		
18.		Market Support—Per Books	24,239.76		
19.		Market Support—Confirmed [4,063.59]			
20.		Market Support—Unconfirmed [20,176.17]			
21.		Total		27,237.10	
22.	Adjusted Expenses ($203,846.57 less L 5, 13, 21)				125,764.37

			Adjustments (Additions)		
22.	Adjusted Expenses				125,764.37
23.	*PLUS*:	Compensation for Working Owners	15,839.40		
24.		Allowance for Owner's Management and Interest on Working Capital	4,259.10		
25.		Total allowance for Owner's Efforts		20,098.50	
26.	*PLUS*:	Allowance for Business Getting and Maintaining (L 16+17+19)	7,060.93		
27.		Allowance for return on buildings and equipment	2,398.60		
28.		Allowance for use of land	3,407.28		
29.		Allowance for additional depreciation	609.81		
30.		Allowance for Bad Debts	2,769.89		
31.				16,246.51	
32.		(L 22+25+31)			162,109.38
33.	*PLUS*:	Allowance For Operating Margin	22,715.20		
34.	Total Reasonable Revenue Requirements				184,824.58
35.	Total Revenue (Selling Commissions & Yardage) Per Audit				214,175.41
36.	Current Revenue in excess of requirement (L 35 – L 34)				29,350.83

Figure — 1

7. The respondent's total expenses in the rendition of auction market services during the base period (July 1, 1972-June 30, 1973), as shown by its books and records, were $203,846.57 (Fig. 1, line 1; Tr. 12).

8. During the base period, respondent paid to Mr. Giles Lowery, who owns 100% of the corporate stock of the respondent, $20,377.29, consisting of $14,070 in salary and $6,307.29 as a livestock solicitor's fee (Fig. 1, lines 3-5). The compensation of $20,377.29 paid by respondent to its working owner was removed by complainant since it was not an amount arrived at through arms-length bargaining (Tr. 13-14, 79-88). An allowance to compensate Mr. Lowery as a working owner was later added (see Finding 17, *infra*).

9. During the base period, respondent paid $14,537.05 in interest on outstanding debts (Fig. 1, line 6). Such interest was paid on a Small Business Administration loan to liquidate debts, and not for capital improvements.

This interest expense was removed by complainant on the grounds that it should not be borne by the consignors of livestock, the ratepayers, but by the corporation's shareholders. If such interest is not removed, the ratepayers would be paying twice for the borrowed funds, once in the form of interest and once in the form of depreciation expenses allowed on depreciable assets purchased with the borrowed funds (Tr. 14, 88-91). No issue is raised on appeal with respect to this item.

10. During the base period, respondent incurred bad debt losses of $4,410.23, which were removed by complainant (Fig. 1, line 7). Since a stockyard operator is required by the Act and the regulations (7 U.S.C. 208, 213; 9 CFR 201.43) to pay consignors by the next business day following the sale of their livestock the net proceeds thereof,

whether or not the purchasers pay, stockyards may, and generally do, incur some bad debt expense. However, in some cases, an extraordinarily large bad debt expense for a particular year has been the sole basis for a request to increase rates. In order to prevent requests for increased rates from being based on what complainant regards as unreasonable bad debt expenses, actual bad debt expenses are removed and replaced with an allowance, discussed in Finding 23, *infra* (Tr. 14, 92-94, 169).

11. During the base period, respondent paid $300 for rent on a pasture about 5 or 10 miles distant from the auction market (Fig. 1, line 8). This was excluded by complainant because complainant determined that the pasture was not used or useful for auction market purposes (Tr. 15, 95-97).

12. During the base period, respondent expended $9,370.78 for trucking and hauling services (Fig. 1, line 9). This was deducted from the allowed expenses because the respondent's records were inadequate and did not indicate that consignors of the market had benefited from these expenses (Tr. 15-17, 95-105; Comp. Ex. 2).

13. During the base period, respondent made contributions to churches of $70.00 and donations to other organizations and individuals of $461.00 (Fig. 1, lines 10 and 11). These expenses were removed by complainant because it is not considered reasonable that ratepayers make involuntary donations to charities not of their choice (Tr. 17-18, 105-106). No issue is raised on appeal with respect to these items.

14. During the base period, respondent incurred miscellaneous expenses of $1,318.75, which were deducted by complainant on the ground that the expenses were not related to the auction market business (Fig. 1, line 12).

The $1,318.75 deducted by complainant consists of the following items:

(a) the proportionate share ($167.82) of a bond premium covering the Bay City operation (Tr. 18-19, 107; Comp. Ex. 3);

(b) franchise taxes of $93.94 applicable to Bay City Livestock Exchange, but paid by the Lufkin Livestock Exchange (Tr. 19, 111; Comp. Ex. 3);

(c) legal fees of $25 and accounting fees of $500 which were for services received in the year preceding the base period (respondent's accounts are kept on an accrual basis, *i.e.*, expenses are to be entered on the books when accrued and not when paid) (Tr. 19, 111-112, 354; Comp. Ex. 3); and

(d) a depreciation expense ($292.95) and a utility expense ($239.04), totalling $531.99, associated with a house adjacent to the auction market, which is furnished by the market to Mr. Leonard Miller and occupied by Mr. Miller and his family.

The employee, Mr. Miller, is a caretaker-custodian who is at the market seven days a week. He is required to live in the house furnished by the market. He prevents vandalism and answers the telephone during the week when office personnel are not at the market. He helps receive cattle if they are consigned early; does minor repairs; keeps the grass cut; cleans up; and is "kind of a utility man" (Tr. 19, 107-111, 379-380; Comp. Ex. 3). The employee, Mr. Miller, receives a salary of approximately $250 per week.

The complainant removed the expenses incident to this house because complainant felt it is inappropiate for for ratepayers to be asked to support an auction market

employee's family beyond the amount of the salary paid that employee (Tr. 19, 107-111; Comp. Ex. 3).

Of the foregoing miscellaneous items totalling $1,318.75, the respondent challenges on appeal only the last item relating to the $531.99 associated with the house occupied by Mr. Leonard Miller.

15. During the base period, respondent's books and records showed Business Getting and Maintaining expenses totalling $27,237.10 (Fig. 1, line 21). Of this amount, $2,497.34 was expended for advertising designed to promote the interests of consignors (Fig. 1, line 16); $500 was expended as livestock "solicitor's expense" (Fig. 1, line 17); and $24,239.76 was entered in an account labeled by respondent as "market support" (Fig. 1, line 18). Of the $24,239.76 "market support" expenses, only $4,063.59 could be verified and confirmed by complainant's audit (Fig. 1, line 19).

All of the Business Getting and Maintaining expenses totalling $27,237.10 were deducted by complainant (Fig. 1, line 21), but the expenses for advertising ($2,497.34), livestock solicitor's expense ($500) and the confirmed market support expenses ($4,063.59) were subsequently added back by complainant (Fig. 1, line 26).

Market support is the term generally used in the auction market business to describe the bidding by a market operator or his representative at auction which bidding ends in the purchase of the animal by the market. Such bids are placed not with the intention to purchase the animal, but rather to stimulate bids from other buyers. This process is entirely voluntary; many markets do not engage in it.

Animals purchased through market support are either again run through the auction ring at the same market or

transported to another market for sale. The market support account at a market is charged with the losses, if any, associated with disposing of such animals. Where applicable, these losses include transportation costs, feed costs and the difference between the purchase price at which the market bought the animal and the selling price of the animal when the market sold it.

Complainant treated as confirmed market support expenses those expenses resulting from the purchase by respondent at respondent's market of specific, identifiable cattle consigned to the market, plus expenses flowing from the sale by respondent of such cattle to named, identifiable, third-party purchasers. In other words, in order to confirm market support expenses, it is necessary to trace the animals head-by-head from consignors to ultimate purchasers (Tr. 23-29, 117-127, 134-142, 147-149, 334; Comp. Ex. 5).

16. Subtracting the foregoing deductions referred to in Findings 8-15, *supra*, which total $78,082.20, from the respondent's total book expenses of $203,846.57 results in the respondent's Adjusted Expenses of $125,764.37 (Fig. 1, line 22). Under the complainant's rate analysis procedure, various additions are made to the market's Adjusted Expenses (Fig. 1, lines 23-33). These additions are set forth in the following Findings of Fact.

17. The complainant added an allowance of $15,839.40 to compensate Mr. Giles Lowery as a "working" owner of the respondent stockyards during the base period (Fig. 1, line 23). Mr. Lowery's primary function at the weekly auction sale is to serve as "starter." A "starter" sets the the starting price or opening bid of consigned cattle when such cattle are placed in the auction ring and put up for sale (Tr. 160).

The allowance of $15,839.40 made for respondent's working owner was derived from a compensation formula used by complainant in rate analyses (Comp. Ex. 6; see, also, Comp. Ex. III attached to Stipulation 3, filed August 9, 1974). The compensation formula provides 50¢ per animal unit on the first 20,000 units sold at the market, 25¢ per unit on the next 20,000 and 5¢ per unit for each unit over 40,000. One cattle, one horse or one mule equals one animal unit under this formula. A hog equals one-third of a unit and a sheep equals one-fourth of a unit (Comp. Ex. 6).

During the base period, the respondent stockyards received on consignment 56,788 animal units, consisting of 56,292 cattle, 827 hogs, and 220 horses (Comp. Ex. 6).

18. The complainant added an allowance for Owner's Management and Interest on Working Capital during the base period of $4,259.10 (Fig. 1, line 24). This allowance was computed on the basis of 6.25¢ per animal unit for management ($3,549.25) and 1.25¢ per animal unit for interest on working capital ($709.85). These amounts are allowed whether or not the owner is actively engaged in the operation of the market on sale days (Tr. 30-33, 160-163, 207-218, 273-287; Comp. Exs. 6, 12; Comp. Exs. IV and IX attached to Stipulation 3, filed August 9, 1974). The portion of the allowance for interest on working capital is not challenged on appeal.

19. An allowance of $7,069.93 was added for respondent's Business Getting and Maintaining expenses during the base period (Fig. 1, line 26). This allowance is based on 25¢ per animal unit sold at auction during the base period, or actual, confirmed expenses during the base period, which ever is less. In this case, the allowance was based on the actual, confirmed expenses referred to in Finding 15, *supra*.

20. An allowance of $2,398.60 was added for respondent's return on buildings and equipment during the base period (Fig. 1, line 27). This allowance was computed on the basis of 8% of the original cost of the buildings (and improvements) and equipment, less depreciation.

Records filed with complainant show that as of December 31, 1967, the undepreciated book value of the Lufkin Livestock Exchange facility was $76,817.18. Accumulated depreciation of $51,383.55 left the net book value of the buildings and equipment of $25,433.63 as of this date. In December of 1968, Mr. Giles Lowery purchased the facility from its original owner, and the operation changed from a calendar year basis to a fiscal year basis ending on June 30 of each year. It was, therefore, necessary to estimate the net book value of the assets as of December 31, 1968, a year for which no annual report for Lufkin Livestock Exchange was submitted to complainant. Since more than $5,000 in depreciation had been taken in 1967, a similar amount would reasonably have been taken in 1968 had the facility remained in the hands of the original owner. For this reason, the net book value of respondent's buildings and equipment was set at $20,000 as of December 31, 1968. A number of capitalized improvements and annual depreciation from that date resulted in the net depreciated book value of respondent's buildings and equipment of $27,130.67 as of June 30, 1973, the close of the base period.

The foregoing book value of buildings and equipment of $27,130.67 was increased by the net value of unloading docks constructed during the base period at a cost of $6,-098.13. Deducting depreciation on the docks of $609.81 left a book value of $32,618.99. However, complainant subtracted from that figure $2,636.53, the book value of the house occupied by Mr. Miller, referred to in Finding

14, *supra*, on the ground that the house is not used and useful for auction market purposes. This left $29,982.46 as the final net book value of respondent's buildings and equipment used and useful for auction market purposes (Tr. 8, 34-37, 127-132, 165-167; Comp. Ex. 7).

21. The complainant added an allowance of $3,407.28 for the stockyard's use of land during the base period (Fig. 1, line 28). The $3,407.28 is based on 6¢ per animal unit sold by the stockyards during the base period. The basis for this formula was explained by Jack W. Brinckmeyer, Chief, Rates, Services and Facilities Branch, Packers and Stockyards Administration, as follows (Tr. 167-168):

> Land values has been a problem. [In] 1958 when I started handling the rate work for our agency we were exploring several methods of determining the value of land, what we should use. If we went back to the original cost as the Hope Natural Gas said we could, it would have had a very startling effect on the industry.
>
> So after trying to index it on farm prices of land and several other things we determined that some allowance for the use of land based on the unit of livestock would probably be the most fair way to the regulated industry and to the rate payer and treat each one of them fairly.
>
> In the early 1960's appraisals had been made of several of the major stockyards. This included Sioux City, St. Paul, Oklahoma City, Louisville, Kentucky, and the land appraisals at that time and the units of livestock were evaluated to determine what the unit allowance would be.
>
> From reviewing those firm's annual reports and the appraisal of the land at those stockyards we came

> up with a unit cost of five point eight-eight cents per unit.
>
> We recommended to the administrator, the Packers and Stockyards Administration, that we adopt the method of allowing a use for land of six cents per unit. We adopted that approximately [in] 1969, as I recall, and since that date all land values of stockyards is based on six cents per unit.
>
> The old method of trying to use appraisals, if you appraised it one day and the next day it was outdated, each individual person had his ideas, we had to follow in determining how much was used and useful such as this, with this allowance the stockyard operator knows that he's going to receive six cents for each unit of livestock that he handles. If he wants to utilize less acres of land he gets a better return for his property. If he wants to spread it out we don't have to go through the problem of determining the useful area and value or trying to determine the original cost. Most of the markets have no records that will support their original cost of the land.

Mr. William J. Jones, Regulatory Marketing Specialist, who is employed by complainant as a livestock market appraisal expert, studied the physical plant of the Lufkin Livestock Exchange and concluded that of the 25 plus acres used by the respondent in its operations, approximately 6½ acres are used and useful for stockyard purposes (Tr. 37, 167-168, 249-272; Comp. Exs. 9-11).

Mr. William Jake Lyons, respondent's expert on land appraisal, testified that the land in question at the time of the hearing was worth $2,050 per acre (Tr. 366-368; Resp. Ex. 5). Assuming this valuation to be correct, the total value of the 6½ acres of land used and useful for stockyard

purposes is $13,325. At the complainant's established rate of return, 8%, respondent's allowance for return on land based on its present value would be $1,066, which is less than one-third of the allowance computed by complainant using the livestock receipts formula. No issue is raised on appeal with respect to this item.

22. An allowance of $609.81 was added for additional depreciation taken on the unloading docks installed by respondent, which are referred to in Finding 20, *supra*. It was stipulated that the cost of these facilities should be capitalized and the appropriate depreciation expense taken (Tr. 37-38; Stipulation 2). No issue is raised on appeal with respect to this item.

23. An allowance of $2,769.89 was added for bad debts during the base period (Fig. 1, line 30). The allowance for bad debts is computed on the basis of .0003 times the gross value of livestock sold on commission by respondent during the base period (Tr. 169-170).

24. An allowance of $22,715.20 was added for an operating margin (Fig. 1, line 33). The allowance for operating margin is computed on the basis of 40¢ per animal unit sold at the auction during the base period.

The purpose of the operating margin is to provide revenue above the actual cost of providing auction services to take care of contingencies. Otherwise, unexpected changes in costs or revenues would place an unwarranted burden on the market operator during the period it would take him to secure a rate change. The operating margin also includes an allowance for the market's income taxes, if any; but most auction markets do not have to pay income taxes as a separate entity from the owners (Tr. 39-40, 170-172, 274-277; Comp. Ex. 12). No issue is raised on appeal as to this item.

25. Adding the foregoing allowances referred to in Findings 17-24, *supra*, which total $59,060.21, to the respondent's Adjusted Expenses of $125,764.37, results in the respondent's Total Reasonable Revenue Requirements of $184,824.58 (Fig. 1, line 34).

26. The respondent's total revenue derived from selling commissions and yardage during the base period was $214,175.41 (Fig. 1, line 35). This figure was determined by complainant from respondent's books and records (Tr. 40, 134).

The respondent's total revenue of $214,175.41 includes about $16,648.63 paid by livestock sellers in connection with livestock purchased by the respondent for market support during the base period (Tr. 134-149, 317-323, 328, 330-336; Resp. Ex. 2).

27. The complainant determined that the current revenue received by the respondent during the base period exceeded its reasonable revenue requirements by $29,350.83 (Fig. 1, line 36), *i.e.*, the difference between the respondent's total reasonable revenue requirements during the base period (Fig. 1, line 34), and the respondent's total revenue received during the base period (Fig. 1, line 35).

Accordingly, the complainant proposed a tariff (Comp. Ex. 8) which would, if applied to the livestock receipts at respondent's auction market during the base period, produce several thousand dollars more than the reasonable revenue requirements of $184,824.58 (Tr. 58-59; Comp. Ex. 8). Rates for additional services other than regular selling and yarding services are also set forth in the complainant's proposed tariff in paragraphs B, C, D, and E thereof (Tr. 41-43, 57-58; Comp. Ex. 8).

The complainant's proposed tariff is based on a per-head-weight schedule, as opposed to the valuation type

tariff presently in effect at the market and at neighboring markets. For example, the complainant's proposed tariff would provide for a selling and yardage charge of $3.00 per head for cattle weighing less than 300 pounds, and $3.50 per head for cattle weighing 300 pounds, and more.

Under a valuation tariff, the rate per head increases as the value increases, *e.g.*, up to $49.99, $2.50 per head; $50.00 through $99.99, $3.50 per head; $100.00 through $149.99, $4.50 per head; and $150.00 and over, $5.00 per head (Resp. Ex. 1, p. 5).

A per-head-weight schedule provides for rates that are stable, regardless of price fluctuations. Such a schedule is nondiscriminatory and reflects more accurately and uniformly than valuation tariffs the cost of the service performed (Tr. 172-176, 225-232).

28. The rates and charges contained in the complainant's proposed rate order (Comp. Ex. 8) are reasonable and nondiscriminatory, and are the rates and charges which respondent should assess for its services and the use of its facilities.

CONCLUSIONS OF LAW

The Packers and Stockyards Act requires that all rates or charges made by a stockyards owner or operator be "just, reasonable, and nondiscriminatory" (7 U.S.C. 206). There is no judicial decision involving an auction stockyards interpreting or applying that broad statutory standard. The three administrative proceedings[3] involving

3. *Secretary of Agriculture* v. *Norfolk Horse and Mule Commission Sales Company*, 1 Agriculture Decisions 372 (1942); *Secretary of Agriculture* v. *H. L. Bowman*, 1 Agriculture Decisions 425 (1942); *In re Foust-Yarnell Stock Yards*, 4 Agriculture Decisions 826 (1945).

rates and charges at auction stockyards were decided more than 30 years ago, during which time there have been major changes in ratemaking principles. Hence, for all practical purposes, this is a case of first impression which will serve as a guide for the Department's rate policy involving about 2,000 auction stockyards. Accordingly, the case warrants an extensive discussion of the numerous issues raised on appeal.

I. *Ratemaking Principles Applicable to Auction Stockyards*

At the outset, the respondent challenges (Appeal, pp. 1-4) the Department's entire procedure for determining rates at auction stockyards because the Department does not follow the traditional public utility ratemaking procedure, which consists of determining a utility's rate base and the reasonable rate of return which the utility owners are entitled to earn on the rate base, after allowance for reasonable operating expenses, depreciation and taxes. The Department follows that traditional public utility ratemaking procedure for terminal stockyards, but not for auction stockyards, in view of the great differences between terminal stockyards and auction stockyards.

The owners of a terminal stockyards provide the land, buildings and facilities where livestock are bought and sold. The selling function is performed by independent market agencies which sell livestock by private treaty in pens and office space assigned by the stockyards company. The owners of large terminal stockyards invest millions of dollars in the stockyards. For example, the rate base for the St. Paul terminal stockyards was $5.1 million (*In re St. Paul Union Stockyards Company*, 21 Agriculture Decisions 1216, 1315 (1962)). The terminal stockyard owners' entire income depends on the return allowed on their investment in the stockyards. From the standpoint

of the source of their income, terminal stockyard owners are analogous to the owners of railroads, electric companies, and other large public utilities. Accordingly, the Department follows the traditional ratemaking procedure of establishing a rate base for the terminal stockyards and a rate of return which the owners are entitled to earn on the rate base, after allowance for reasonable operating expenses, depreciation and taxes.

On the other hand, the investment in an auction stockyards is generally less than $50,000 (Tr. 199), or only 1% or 2% of the investment in the large terminal stockyards. The great majority of the auction market owners actively work at their auction markets, and a large part of their stockyards income comes from the allowance computed by the Department for a working owner. From the standpoint of the source of their income, working auction owners are analogous to owner-operators of individual taxicabs. Since Giles Lowery, the respondent's owner, is a working auction market owner, this case must decide what ratemaking principles apply to an auction stockyards with a working owner. There is no need, and it would not be appropriate) to consider whether any different ratemaking principles would apply to the relatively few auction markets in the country which do not have working owners.[4]

In *St. Joseph Stock Yards Co.* v. *United States,* 298 U.S. 38, 49, involving a $3.7 million terminal stockyards (298 U.S. at 55), the Court stated (298 U.S. at 49):

> The question is not one of fixing a reasonable charge for a mere personal service subject to regulation under the commerce power, as in the case of

4. This should not be construed as an indirect suggestion that different principles would apply—but simply as an expression of the fact that no consideration is being given in this case to the question of rates at an auction market where the owner does not work at the market.

> market agencies [at a terminal stockyards] employing but little capital. * * * Here, a large capital investment is involved and the main issue is as to the alleged confiscation of that investment.

Auction market owner-operators resemble market agencies at a terminal stockyards (where a large part of their income results from "personal service") more nearly than they resemble owners of a terminal stockyards (where 100% of their stockyards income comes from the return on their investment). This "personal service" aspect of auction market owner-operators compels the use of ratemaking principles quite different from those used generally in public utility ratemaking proceedings.

Another significant difference between terminal stockyards and auction stockyards is that there has never been a problem in this country of two competing terminal stockyards being built in the same city or within a few miles of each other. Hence there has never been a problem resulting from the construction of too many terminal stockyards.[5] On the other hand, there have been serious problems in some areas of the country resulting from the construction of too many auction stockyards. It is not unusual in some areas to have two auction stockyards in the same town, and perhaps six or eight auction stockyards, or more, within less than an hour's drive away.[6]

5. However, as the livestock industry has changed over the years, about half the terminal stockyards in operation in 1922 have ceased operations (*e.g.,* Chicago) or converted to an auction market (*e.g.,* Denver). See *Packers and Stockyards Resume,* Vol. XIII, No. 7 (P&SA, U.S.D.A., December 19, 1975), p. 34.

6. For example, in a recent Packers and Stockyards Act case which I decided, *In re Overland Stockyards, Inc.,* 34 Agriculture Decisions 1808 (decided December 23, 1975), the record shows that there were two auction stockyards located in the same town, and five other auction stockyards within 25 miles. See, also, Comp. Ex. IX, p. 11, attached to Stipulation 3, filed August 9, 1974.

It is important to note that anyone is free to build a stockyards wherever and whenever he pleases. No franchise or certificate of public convenience and necessity is required (see 9 CFR 203.8(e)). The Secretary is required to "post" every stockyards which is built irrespective of whether or not it is needed (7 U.S.C. 202), and to register every "market agency" who chooses to operate an auction stockyard (7 U.S.C. 201, 203). (Similarly, no governmental permission to cease operating a stockyards is required).

The respondent's stockyard is located in Texas. A study published by Texas A. & M. University in 1966 concluded that "from the standpoint of operational efficiency, there are too many auctions in operation in Texas" (Comp. Ex. IX, p. 3, attached to Stipulation 3, filed August 9, 1974).[7] Specifically, the study concluded that 37% of all Texas auction markets were submarginal or marginal in efficiency because of the small volume of livestock they handled (*id.* at p. 2). The study concluded that the "prospect of auctions solving the efficiency problems of small markets through general increases in volume do not appear bright" (*ibid.*). The study explained why speculative capital has been available to invest in auction markets even in fringe areas of potential profitability as follows (*id.* at pp. 11-12):

> One of the primary determinants of whether a livestock market will be located in a town or community is pressure from local business and community leaders. In smaller communities particularly, an auction is considered to have an economic influence well beyond its contribution to the general sales base.

7. The Texas A. & M. study is authored by Charley V. Wootan, Associate Executive Officer, Texas Transportation Institute, and John G. McNeely, Professor, Department of Agricultural Economics and Sociology, Texas A. & M. University. It is titled: *Factors Affecting Auction Market Operating Costs* (B-1056, October 1966).

An auction market draws business to a community. Receipts from the sale of livestock are often banked and spent in the community where the auction is located. A multiplier effect from the primary source of income results in continued transfer of money within a community, giving a greater impact upon the economic activity than just the initial amount of money introduced into the community.

This anticipation of economic side benefits has caused many auctions to be started in areas already adequately served by facilities in nearby communities. Also it probably has been responsible for auctions being established in areas that do not have potential marketing volumes to support adequately a market of efficient size.

> There appears to be adequate speculative capital available to establish markets in even the fringe areas of potential profitability. Many of these markets must be refinanced one or more times as the original owners find they cannot be operated profitably. The ready availability of both capital and potential auction operators has kept the number of markets fairly constant during the past several years, even though many locations have proven unprofitable.

The problem of high unit costs and inefficiency because of too many auction stockyards is not, of course, limited to Texas. See Williams and Stout, *Economics of the Livestock-Meat Industry* (1964), p. 254; Fowler, *The Marketing of Livestock and Meat* (1961), p. 298.

Obviously, it is not in the public interest to have too many stockyards in an area. As stated in the Texas A. & M. study referred to above (*id.* at pp. 3, 5):

The continuing large number of high cost, inefficient small-volume firms is evidence of considerable overinvestment in livestock auction markets. This overinvestment in plant, equipment, labor and associated marketing expenses results in a much higher social cost of auction operations than would exist with fewer firms having higher volumes and lower unit costs.

* * *

Overcapacity and its resulting inefficiencies are important to the public in general as well as to the operators of the markets and to livestock producers who use those facilities.* * *

* * *

He [i.e., the livestock producer] may be subject to indirect losses, though, that are less noticeable but potentially greater in size [than from higher marketing charges]. These occur when either excessively small market size or high unit costs restrict the auction in its market performance.

Unnecessary marketing expenses resulting from too many stockyards injures producers and consumers since "[e]xpenses incurred in the passage through the stockyards necessarily reduce the price received by the shipper, and increase the price to be paid by the consumer" (*Stafford* v. *Wallace*, 258 U.S. 495, 515).[8]

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8. Another problem resulting from too many stockyards in an area is that the auction owners, in an effort to maintain adequate volume to attract buyers, may engage in extensive dealer operations to personally bring sufficient livestock to the market to attract buyers. Where a number of auction owners in the same area are engaging in this practice, it may result in the same animals moving through several auction markets during a period of a few days, which results, of course, in undue stress to the animals and unnecessary marketing expenses. In addition, the unnecessary proliferation of auction markets requires an increased number of buyers to cover the increased number of markets, which adds further unnecessary marketing expenses.

In these circumstances, livestock sellers and consumers should not be burdened with stockyard rates sufficiently high to insure that *every* auction market owner will be able to pay all of his reasonable expenses and make a reasonable return on his rate base. The cases holding that it is a confiscation of property in violation of the due process clause of the Fifth Amendment to the Constitution to establish a stockyards rate that does not yield a reasonable return on the owners' rate base, after reasonable expenses, involve terminal stockyards (*Denver Stock Yard Co.* v. *United States*, 304 U.S. 470, 475; *St. Joseph Stockyards Co.* v. *United States*, 298 U.S. 38, 49). The holdings in those terminal stockyard cases should not be extended to auction stockyards as to which the facts and public interest are essentially different.[9]

In view of the significant differences between auction stockyards and other public utilities, including terminal stockyards, the rate base-rate of return procedure followed as to other public utilities is not appropriate for use (except in a very limited respect, discussed below, relating to the allowance for buildings and equipment) in auction stockyard rate proceedings. Accordingly, it is not appropriate in an auction stockyard rate proceeding to determine by the use of a rate base and rate of return formula whether the permitted rates confiscate property in violation of the due process clause of the Fifth Amendment to the Constitution.

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9. Although the respondent stockyards handles sufficient volume to be efficient, the problem of too many stockyards, resulting in many inefficient markets, is applicable to respondent's argument that *every* auction market must be permitted a rate that will yield a fair return on its rate base, i.e., a non-confiscatory rate. But of even more importance requiring a rejection of respondent's argument is the fact that a large portion of an auction stockyard owner's return is based on personal service, and, therefore, the return on his investment is only a small fraction of his total return from the stockyards.

But even in those public utility proceedings where it is appropriate to determine whether the rates are confiscatory because a reasonable return, after expenses, is not allowed on the rate base, it is recognized that the rights of the public must be considered. And, in particular circumstances (*e.g.*, where there is lack of adequate volume), the public interest requires and justifies the fixing of public utility rates that are not as high as would ordinarily be fixed under the customary ratemaking principles.

> It cannot, however, be laid down as an absolute rule, that in every case, a failure to produce some profit to those who have invested their money in the building of a road is conclusive that the tariff is unjust and unreasonable, because this may be the result of wasteful or extravagant management; the construction may have been at a time when material and labor were at the highest price, so that the actual cost far exceeds the present value; or the road may have been unwisely built in localities where there is not sufficient business to sustain a road. Likewise, if by reason of its ill-advised contracts with other carriers rates fairly equivalent to the value of the services rendered fail to yield a fair return, the carrier must bear the loss. It is well established, therefore, that a corporate carrier cannot, as of right, and without reference to the interests of the public, realize a given percent on its capital stock, since stockholders are not the only persons whose rights or interests are to be considered (footnotes omitted).[10]
>
> [R]ates are not necessarily confiscatory although they do not pay a reasonable return on the investment, since the plant may have been constructed on too large a scale.[11]
>
> The interest both of the public and of the utility should be considered, but it is not always possible to do full justice to both, and where this is the case, the rights of the public must prevail.[12]

10. 64 Am Jur 2d, Public Utilities, § 217, p. 724.

The applicable rule was stated in a concurring opinion by Mr. Justice Black, Mr. Justice Douglas and Mr. Justice Murphy in *Federal Power Commission* v. *National Gas Pipeline Company*, 315 U.S. 575, 607-608, as follows:

> The consumer interest cannot be disregarded in determining what is a "just and reasonable" rate. Conceivably, a return to the company of the cost of the service might not be "just and reasonable" to the public. The correct principle was announced by this Court in *Covington & Lexington Turnpike Co.* v. *Sandford*, 164 U.S. 578, 596: "It cannot be said that a corporation is entitled, as of right, and without reference to the interests of the public, to realize a given per cent upon its capital stock. When the question arises whether the legislature has exceeded its constitutional power in prescribing rates to be charged by a corporation controlling a public highway, stockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored. It is alleged here that the rates prescribed are unreasonable and unjust to the company and its stockholders. But that involves an inquiry as to what is reasonable and just for the public. If the establishing of new lines of transportation should

11. 64 Am Jur 2d, Public Utilities, § 191, p. 706.

12. 64 Am Jur 2d, Public Utilities, § 191, p. 705.

cause a diminution in the number of those who need to use a turnpike road, and, consequently, a diminution in the tolls collected, that is not, in itself, a sufficient reason why the corporation, operating the road, should be allowed to maintain rates that would be unjust to those who must or do use its property. The public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends."[13] Cf. *Chicago & Grand Trunk Ry. Co.* v. *Wellman,* 143 U.S. 339, 345-346; *United Gas Co.* v. *Texas,* 303 U.S. 123, 150-151.

Accordingly, even if the validity of auction market rates were to be tested by whether they provide a reasonable rate of return on the applicable rate base, after reasonable expenses, there is no basis for respondent's contention that every auction market owner is entitled to a reasonable return on his rate base, irrespective of whether the market handles an adequate volume of livestock.

Considering all of the facts and circumstances relating to the livestock industry, it is my view, and I so hold, that *with respect to auction stockyards* the due process clause of the Fifth Amendment to the Constitution requires rates that produce sufficient revenue to enable a prudently managed auction stockyards to remain in business only if (i) the auction stockyards handles a sufficient volume of livestock to be a reasonably efficient live-

13. *The Covington & Lexington Turnpike* decision quoted from above continues (164 U.S. at 597): "If a corporation cannot maintain such a highway and earn dividends for stockholders, it is a misfortune for it and them which the Constitution does not require to be remedied by imposing unjust burdens upon the public."

stock market;[14] and (ii) the investment in the auction stockyards was prudent (*i.e.,* see the quoted material referenced by footnotes 10 and 11 above). (Under this standard, which does not guarantee the survival of inefficient markets, the Department could, if it desired, determine just and reasonable rates on an area basis, based on investment and expense data determined to be prudent and reasonable.)

Where the criteria in the preceding paragraph are met, the complainant discharges its duty to an auction stockyards owner and treats the ratepayers fairly where the rates are set at the lowest level that will provide revenue sufficient for (i) all of the market's operating expenses prudently and economically incurred; (ii) an annual charge for depreciation based on the expected life of the stockyards; (iii) taxes imposed on the stockyards; (iv) interest on debt prudently incurred; and (v) a reasonable return to the owner for his prudent investment and personal services (considering as a unit all of the income received from the stockyards, including allowances for a working owner, owner's management, interest on working capital, return on buildings and equipment, use of land, and that portion of the operating margin which is reasonably expected to be available for the owner's personal use at the time).[15] *Cf. In re St. Paul Union Stock-*

14. The study published by Texas A. & M. University, referred to above, considered markets handling 15,000 animal units "inefficient" and "submarginal," and markets handling less than 25,000 animal units "at a disadvantage from the standpoint of efficiency and * * * only marginal" (Comp. Ex. 9, p. 2, attached to Stipulation 3, filed August 9, 1974). However, it is for complainant to determine in the first instance what volume should be used for the purposes of this standard. The respondent's volume of 56,788 animal units (Finding 17, *supra*) would not be close to the line, wherever it is drawn.

15. The omission of "ability to attract capital" is deliberate since, as shown above, a major problem in the livestock auction industry is that too much capital is attracted, even to marginal markets.

yards Company, 21 Agriculture Decisions 1216, 1291 (1962); *Federal Power Commission* v. *Hope Gas Co.,* 320 U.S. 591, 605; 64 Am Jur 2d, Public Utilities, § 135.

II. *Rate Regulation in Public Interest*

The respondent argues that in view of the significant changes that have occurred in the livestock industry since the enactment of the Packers and Stockyards Act in 1921, including the great number of auction markets now in existence, there is no longer any justification for rate regulation.

Respondent is, of course, correct in arguing that there have been great changes in the livestock industry since 1921.[16] When the Act was passed, most livestock moved by railroad. Hence the few terminal stockyards in the United States, which were located at rail centers, had virtually monopolistic positions.[17] It was such terminal stockyards that the Court referred to in 1922 as the "great stockyards" which "are but a throat through which the current [of livestock] flows" (*Stafford* v. *Wallace,* 258 U.S. 495, 497, 514, 516).

Since auction stockyards were "practically nonexistent in 1920,"[18] the Congressional Committee was referring to terminal stockyards when it said in 1920 and 1921 in the legislative history of the Act (Sen. Rep. No. 429,

16. See Engelman, *Trends in Livestock Marketing Before and After the Consent Decree of 1920 and the Packers and Stockyards Act of 1921,* Statement to the Subcommittee on SBA — SBIC Legislation, House Small Committee (P&SA, U.S.D.A., June 23, 1975).

17. It was estimated in 1921 that there were only 30 to 50 stockyards in the entire country which would be regulated by the Act at that time (H. Rep. No. 77, 67th Cong., 1st Sess., p. 10).

18. Williams and Stout, *Economics of the Livestock-Meat Industry* (1964), p. 232. See, also, Fowler, *The Marketing of Livestock and Meat* (1961), p. 255.

66th Cong., 2d Sess., p. 3; Sen. Rep. No. 39, 67th Cong., 1st Sess., p. 7):

> The enactment of this bill is recommended upon the ground that the great public markets in which is handled the live stock that supplies the demand for the American consumption of 19,000,000,000 pounds of meat and meat products annually are public utilities and that as such they should be subject to supervision * * *

With the improvement of roads and trucks, livestock no longer was limited to rail movement, and the auction industry developed rapidly. By 1949, there were almost 2,500 auction stockyards in the United States.[19] Many of these stockyards were too small to meet the regulatory criterion set forth in the Act, which stated that the Act did not apply to stockyards "of which the area normally available for handling livestock, exclusive of runs, alleys, or passage ways, is less than twenty thousand square feet" (7 U.S.C. 202(a)). In 1958, following extensive hearings, Congress determined that it was in the public interest to extend the regulatory provisions of the Act to all of the auction stockyards in commerce, including those which were too small to meet the 20,000 square foot limitation. The legislative history of the 1958 amendments states (Sen. Rep. No. 1048, 85th Cong., 1st Sess., pp. 3-4):

> *Livestock markets*
>
> When this act was passed in 1921, there were relatively few livestock markets and these were located primarily in large terminals. Most of the interstate movement of livestock was by railroad. In the early years of operation under the act all of the eligible

19. Packers and Stockyards Resume, Vol. XIII, No. 7 (P&SA, U.S.D.A., December 19, 1975), p. 34.

markets were posted and the record shows that until 1930 these averaged less than 80 for the entire United States.

As transportation facilities—particularly roads and trucks—improved, railroads ceased to be an important limiting factor on livestock movement and the character of livestock marketing began to change. More auction markets developed: In 1930 there were 73 posted stockyards; by March 18, 1957, this number had increased to 439 and the Department of Agriculture estimates that there are at least an additional 500 stockyards still unposted which are eligible for posting (engaged in interstate commerce and with an area of 20,000 square feet or more).

More important, there have developed throughout the country an additional 1,400 or 1,500 country auctions and livestock markets which are engaged in interstate commerce but which are not under the jurisdiction of the Packers and Stockyards Act because of the size limitations in the act. Although these markets are technically under the jurisdiction of the Federal Trade Commission, there has been no effort by the FTC to regulate trade practices on these markets.

Equally significant is the growth which has taken place in country buying—buying by packers or by livestock dealers direct from the producer, without the animals going through a public stockyard or market. There was little or no such buying at the time the Packers and Stockyards Act became law but it is today a common practice in almost every part of the country and more than 40 percent of all livestock sold moves in this manner. The Department of Agriculture has no jurisdiction over this country buying except that which is done by buyers for packers.

* * *

CHANGES MADE BY THIS BILL

From the foregoing it is obvious that the area in which the Packers and Stockyards Act is designed to operate has changed so substantially since 1921 that the Secretary of Agriculture is today charged by the act with responsibility over businesses and operations which could never have been intended by the framers of the legislation and is, on the other hand, powerless to take any action in some matters which have become an important and vital part of the livestock and meat packing industry. The bill reported herewith is a committee bill, drafted by the committee following extensive hearings on this matter. It is designed to amend the Packers and Stockyards Act so as to make it once again an effective instrumentality for the regulation of the livestock and meatpacking industry and for the protection of both producers and consumers. Specific changes are made in the act to meet the problems outlined above. These changes are:

* * *

(5) The Secretary of Agriculture is given jurisdiction over all livestock marketing involved in interstate commerce including country buying of livestock and auction markets, regardless of size.

Notwithstanding the drastic changes in livestock marketing since 1921, and the competition now afforded by some 2,000 auction stockyards, I believe that it is still in the public interest to regulate stockyard rates. Based on discussions with leading livestock marketing experts throughout the United States from December 1962 to January 1971, during which time I was administrator of the Packers and Stockyards Act regulatory program, I believe that stockyard rates would double in the absence of rate

regulation, thereby substantially increasing marketing costs, to the detriment of producers and consumers. But neither respondent's view nor my view in this respect is of any consequence since Congress decided in 1921 that it is in the public interest to regulate stockyard rates, and reaffirmed and extended that decision in 1958. Only Congress can alter that decision.

III. *Base Period*

The complainant's rate analysis in this case is based on its audit of the respondent's books and records for respondent's fiscal year 1973, *i.e.*, July 1, 1972-June 30, 1973. The respondent contends that the complainant should have used the figures for respondent's 1974 fiscal year's operation.

The respondent's last sale for its 1974 fiscal year was held on June 24, 1974 (Tr. 53), which was just one day prior to the beginning of the oral hearing in this case.

The complainant used respondent's 1973 fiscal year figures because they were the latest figures available for an entire fiscal year, and they involved the fiscal year in which the respondent requested the rate increase which led to the present proceeding. Since it takes several months to make a complete audit of an auction market's operations in order to prepare for a rate hearing, the 1974 fiscal year figures could not have been analyzed in time for the hearing which began on June 25, 1974 (Tr. 235-236).

Although it is possible to use figures for less than a year's operations and annualize them, complainant prefers to analyze a full year's operations since this produces more reliable figures. The volume of livestock received at an auction market varies, to some extent, depending on the season of the year; also the time when various costs are incurred and entered in the records varies throughout the

year. Accordingly, it is much more accurate to analyze a full year's operations rather than a portion of a year (Tr. 145-146).

Mr. Jack W. Brinckmeyer, Chief of complainant's Rates, Services and Facilities Branch, testified (Tr. 235):

> You have to establish a test period and move forth from there. If you continue to try to update it you would never reach a point where you could make a determination of what the reasonable costs were.

In the case of *In re St. Paul Union Stockyards Co.*, 21 Agriculture Decisions 1216, 1225 (1962), a "cut-off" date of October 31, 1957, was established because it was found "impracticable to keep revising the evidence adduced so as to have it current as of the conclusion of the proceeding." The case was decided five years later. The Judicial Officer stated in that case (21 Agriculture Decisions at 1225):

> It was recognized, of course, that the record would not be wholly reflective of current conditions at the time of the issuance of the final order in the proceeding, but it was believed desirable to obtain a resolution of the sharp conflict between the parties as to the basic concepts and principles which should govern the determination of such matters as (1) the property of respondent that should be considered used and useful for the rendition of stockyard service and included in the rate base, (2) the valuation of such property and the allowance for working capital upon which respondent is entitled to earn a fair return, (3) the rate of return respondent is entitled to earn, (4) the amounts allowable for repairs and depreciation, and (5) other expenses allowable in the furnishing of stockyard services.

In the *Palestine, Texas* case (Gas Utilities Docket No. 494) relied on by the respondent (Brief, p. 4) and attached as an appendix to the respondent's brief, the calendar year 1971 was used as the test year; hearings on the matter were held March 16 and April 12, 1973; and the decision was served May 9, 1974.

The respondent is particularly interested in having the 1974 fiscal year figures used because its volume dropped 22.5% from fiscal year 1973 to fiscal year 1974.[20] Previously, however, the respondent's volume of livestock had been "fairly stable" (Tr. 44),[21] and the complainant believed that the decline in fiscal year 1974 was a temporary phenomenon resulting from livestock producers temporarily holding their cattle from market (Tr. 153, 290-295).

In view of the significant decline in respondent's livestock receipts from fiscal year 1973 to fiscal year 1974, Mr. Ralph R. Hammond, the complainant's auditor responsible for the rate audit in this proceeding, admitted on cross-examination that "it's possible" that a much truer picture of what the condition is today might be obtained by making an audit for 10 or 11 months in fiscal year 1974 and annualizing the figures (Tr. 154).

In this case, however, since the hearing began on June 25, 1974, and since it takes several months to audit an auction market for the purposes of a rate proceeding (Tr. 235-236), the complainant could not have audited figures for 10 or 11 months in fiscal year 1974; at best, it could have taken figures for 6 or 7 months, and annualized them. This would have been entirely unsatisfactory (Tr. 145-146).

20. Computed from Comp. Ex. 6 (57,339 head in F.Y. 1973) and Resp. Ex. 4, p. 2 (44,464 head in F.Y. 1974).

21. Respondent's volume of cattle marketed in fiscal years 1970-1973 were 56,011 head, 54,379 head, 59,463 head, and 56,292 head, respectively (Comp. Ex. 9).

Moreover, assuming that the complainant's view was correct that the fiscal year 1974 decline in livestock resulted from the temporary withholding of livestock by producers, the 1973 fiscal year receipts would give a much better indication of respondent's future receipts than the 1974 fiscal year receipts. Since ratemaking looks to the future, temporary abnormalities should not form the basis for future rates. *St. Joseph Stock Yards Co.* v. *United States*, 298 U.S. 38, 46-49.

The time lag problem complained of by respondent in this case is inherent in any protracted rate proceeding. However, there is a simple remedy available to the respondent which does not involve the impossible task of trying to continually update the evidence. Respondent has merely to file an application for increased rates based on more recent data, and it will be acted upon by complainant, irrespective of the outcome of this proceeding (Tr. 54, 56, 235). See, *e.g.*, *Federal Power Commission* v. *Hope Gas Co.*, 320 U.S. 591, 615.

Once the validity of the complainant's procedure is determined in this proceeding, any changes required to be made in the complainant's proposed rate order resulting from changed circumstances can be easily taken care of by a request for a rate increase based on such changed circumstances. In order to be sure that the complainant will have adequate time following the completion of this proceeding, including possible judicial review thereof, in which to analyze a request for a rate increase based on later data, the effective date of the final order in this proceeding will be delayed for 30 days, which will be further extended if necessary.

IV. *Allowances in Lieu of Actual Expenses*

The respondent contends (Appeal, pp. 4-5) that the complainant's ratemaking procedure is invalid because complainant substitutes allowances for various actual expenses. However, as shown in Finding 6, *supra*, 62% of respondent's actual expenses were accepted by complainant as reasonable and necessary. Complainant substitutes allowances for actual expenses with respect to only four categories of expenses, *viz.*, (i) interest on working capital; (ii) owner's compensation (as worker and/or manager); (iii) business getting and maintaining; and (iv) bad debts.

The respondent does not challenge on appeal the amount of the allowance for the first item, interest on working capital. As to the second and third items (the amount of the allowance for the third item is not challenged on appeal), in *Tagg Bros.* v. *United States*, 280 U.S. 420, 440-442, the Court affirmed the Secretary's rate determination under the Packers and Stockyards Act "based upon an assumed cost of the service [including owner's compensation and business getting and maintaining expenses] which disallowed expenses actually incurred" (280 U.S. at 441). As to the fourth item, bad debts, the Court in the *Tagg Bros.* case affirmed the Secretary's rate order notwithstanding the fact that the Secretary removed bad debts as an expense, and made no allowance whatever for bad debts (280 U.S. at 441-442). *A fortiori*, an allowance for bad debts based on the industry average bad debt experience is valid. Hence the *Tagg Bros.* case is squarely in point with respect to the challenged allowances.

In addition, the complainant's substitution of reasonable allowances for an owner's determination of his own worth is supported by *United Gas Co.* v. *Texas*, 303 U.S. 123, 148-151, concuring opinion by Mr. Justice Black; *A.T.&T. Co.* v. *United States*, 299 U.S. 232, 239; *Western*

Distrib'g Co. v. *Comm'n*, 285 U.S. 119, 125-127; and *Chicago &c. Railway Co.* v. *Wellman*, 143 U.S. 339, 345-346.

The allowances specifically challenged will be further discussed in the two following subsections.

A. *Owner's Compensation*

Mr. Giles Lowery, the President and sole owner of the respondent stockyards, paid himself a salary of $14,070.00 and a livestock solicitor's fee of $6,307.29, or a total of $20,377.29 during the base year (Findings 3 and 8, *supra*). This amount was removed by complainant from respondent's expenses and replaced by allowances for Mr. Lowery's efforts as a working owner ($15,839.40) and manager ($3,549.25) of the market in the total amount of $19,388.65, or $988.64 less than Mr. Lowery's salary and fee received from the stockyards (computed from Findings 8, 17 and 18, *supra*). An additional $709.85 was allowed by complainant for Mr. Lowery's interest on his working capital (Finding 18, *supra*), but the allowance for interest is excluded from the discussion herein since it is different from the allowance for Mr. Lowery's efforts as a worker and manager of the market.

The petitioner contends on appeal that Mr. Lowery's efforts as a worker and manager justify his compensation of $20,377.29 (Appeal, pp. 9-10). The complainant's allowances for Mr. Lowery's efforts as a working owner and manager are only 4.85% less than the compensation received by Mr. Lowery from the stockyards ($988.64 ÷ $20,377.29). Although the difference between complainant's allowances and Mr. Lowery's compensation is small, the principle is important since the compensation which the owner of a stockyards pays himself is not an arms-length transaction. It is, therefore, essential that the com-

plainant substitute an allowance for the owner's compensation as a worker and manager (Tr. 13-14, 79-88, 159).

The allowance of $15,839.40 made for Mr. Lowery as a working owner of the respondent stockyards was derived from a compensation formula used by complainant in rate analyses. The compensation formula provides 50¢ per animal unit on the first 20,000 units sold at the market, 25¢ per unit on the next 20,000 and 5¢ per unit for each unit over 40,000. One cattle, one horse or one mule equals one animal unit under this formula; a hog equals one-third of a unit; and a sheep equals one-fourth of a unit (Finding 17, *supra*).

The concept of the animal unit was devised because the cost associated with the sale of different species varies according to the species; but revenue analysis requires consistent treatment of all livestock sold at a market. The conversion formula adopted by complainant was supported by a statistical analysis by Mr. Everett Stoddard, an Agricultural Economist for complainant (Tr. 274-275; see, also, Comp. Ex. IX, pp. 9-11, attached to Stipulation 3, filed August 9, 1974).

The 20,000 break in the compensation formula derives from *In re Market Agencies at Sioux City Stock Yards*, 9 Agriculture Decisions 4, 92 (1950), where it was found that 20,000 units is a reasonable yearly sales volume for one cattle salesman, although some salesmen can sell twice that number, or more. Of course, there are no cattle salesmen at an auction market, but complainant analogizes one cattle salesman to one working owner (Tr. 159-162, 207-218).

The 40,000 break is based on the concept that above this point additional people probably will have to be hired to accomplish the task (Tr. 161; see, also, Comp. Ex. IX, pp. 19-20, attached to Stipulation 3, filed August 9, 1974).

The 5¢ per unit compensation on sales above 40,000 per year is designed to give the working owner some incentive to increase his volume (Tr. 161).

The *Sioux City* case, *supra*, holds that the allowance for a working owner should be no greater than the going rate for the work that the owner actually performs; that is, the allowance should equal the amount for which the market could hire a third party to perform the job. Mr. Giles Lowery's primary function at the respondent stockyards is to serve as the starter at the weekly auction (Tr. 160). Starters generally receive $100 per weekly sale, or less (Tr. 160, 213; Comp. Ex. III attached to Stipulation 3, filed August 9, 1974).

The complainant's present formula for computing a working owner's allowance was adopted in 1970, and is reviewed yearly. Mr. Jack W. Brinckmeyer, Chief of complainant's Rate Branch, testified that the formula still provides more than adequate compensation for a market's working owner (Tr. 207-209).

Added to Mr. Lowery's allowance of $15,839.40 as a working owner is an allowance of $3,549.25 as the manager of the market. The allowance for management is based on 6.25¢ per animal unit, and is allowed irrespective of whether the owner works at the market.

The 6.25¢ figure derives from the *Sioux City* case, *supra* (9 Agriculture Decisions 4, 99), where such amount was deemed reasonable. In 1970, in order to determine whether the allowance was still reasonable, complainant surveyed markets having pure management costs, that is, markets having managers performing no other function. That survey indicated that management costs averaged 5.3¢ per animal unit sold. In other words, the survey indicated 6.25¢ per animal unit is generous (Tr. 161-163, 215-217).

In determining the reasonableness of the complainant's allowances for Mr. Giles Lowery's compensation, an important consideration is the fact that owning and managing a market such as the respondent stockyards is not a full-time occupation. The market has a livestock sale only one day a week. In addition to working at that sale, Mr. Giles Lowery operates an auction market at Bay City, Texas, he is engaged in business as a livestock dealer and he has other business activities (Tr. 208, 218).

Considering all of the facts in this case, if the complainant's allowances for Mr. Giles Lowery's compensation as the owner and manager of the market are in error, the error is in respondent's favor.

An obvious shortcoming of the complainant's allowances for owner's compensation is that they provide the same *rate* irrespective of the quality of the work or the extent of the owner's effort.[22] However, this shortcoming is partially diminshed since the owner's actual compensation is based on the rate times the volume; and it is likely that increased effort or excellence of effort will result in greater volume, and thus greater compensation. But even with this shortcoming, the allowance is superior to a determination by a market owner as to his own worth.

B. *Bad Debts*

The respondent's bad debt losses of $4,410.23 incurred during the base period were removed by complainant and replaced with an allowance of $2,769.89 (Findings 10 and 23, *supra*). The allowance for bad debts was computed on the basis of .0003 times the gross value of livestock sold by

22. Complainant's attorney stated in response to a question by the Judicial Officer that if a working owner performed functions *greatly* in excess of a normal working owner's functions, the allowance for a working owner would be increased.

the respondent at the stockyards during the base period (Tr. 14, 39, 92-95, 146, 169). The allowance is included by complainant even if a market has no bad debts (Tr. 146). The rationale for the allowance was explained by Jack W. Brinckmeyer, Chief of complainant's Rate Branch, as follows (Tr. 169-170):

> As Mr. Hammond testified, and I think we started making this allowance approximately five or six years ago, at one time there was no allowance made for bad debts.
>
> They were just taken out of the formula [a]nd forgot[ten] about.
>
> But we realized that since the market operator was required to pay for the livestock when it was sold and that he had to make collections that there could be some losses from these activities.
>
> However, there again experience showed that the market operator if he had an extraordinary bad debt in one year this was basically his whole justification for trying to modify an increase in rates.
>
> In 1968 we surveyed the entire auction industry in the United States to determine the bad debt losses for the years 1965 and 1966.
>
> That survey showed that the bad debt loss for those two years averaged this .0003 in relation to the [gross] value of livestock sold.
>
> So it was determined that we would take out whatever bad debts were shown and replace them by this allowance based on the experience of the industry, based on the philosophy that if this amount [was] provided for rates each year that over a period of time that should have equaled the amount of bad

debts that a prudent management would have at their market.

Again, to see that our figures were still reliable and current or at least reliable, last year for the [years] 1972 and 1973 bad debt losses have been surveyed for the auction industry, and I don't have the exact figures here, but I think in 1972 it was .00019 and in 1973 it was .0002 something.

Both years show that the average put together that it would be less than .0003 so we're continuing to use that factor for our allowance for bad debts.

For many years, the complainant removed all bad debt expenses and made no allowance for bad debt losses. However, in 1968 or 1969, the complainant began making an allowance based on the stockyard industry's average bad debt experience (Tr. 169). The allowance is reasonable. If a market operator is prudent, his bad debt experience should, over a period of years, be close to the industry average. If he is imprudent, there is no basis for making his particular shippers suffer the consequences of his imprudence.

Even if a market owner suffers bad debt losses over the years greater than the industry's average, without any negligence or imprudence on his part, there is no reason to make his shippers suffer the consequences of such losses.

A market owner is not required to extend credit to any buyer. He can demand cash from all purchasers, or from particular purchasers who have not established their financial standing with the market owner. Moreover, when credit is extended, the purchaser ordinarily pays for the livestock within a week. The regulations issued under the Act require packers, market agencies and dealers purchasing livestock to pay for such livestock before the

close of the next business day following the purchase thereof, unless otherwise expressly agreed between the parties before the purchase of the livestock (9 CFR 201.43 (b)). The Department stated in the explanation accompanying this regulation (29 F.R. 1796):

> The purpose of the amendment is to establish a uniform rule regarding payment for livestock purchased by packers, market agencies, and dealers consistent with (1) the established custom that sales of livestock are on a cash basis, and (2) the provisions of present § 201.43 of the regulations under which market agencies selling livestock on a commission basis transmit or deliver net proceeds to shippers before the close of the next business day following the sale of the shippers' livestock.

The foregoing "prompt payment" regulation, together with the custom either to demand cash payment, or, more frequently, to require payment in a few days, results in extremely small bad debt losses in the stockyards industry.

The respondent argues that the First Bank and Trust, Lufkin, Texas, a banking corporation with $50 million in assets, had a bad debt experience of one-half of one percent (Tr. 420; Appeal, pp. 10-11). However, banks are in the business of lending money on a long term basis whereas the livestock industry is essentially "on a cash basis" (29 F.R. 1796). This explains why the stockyards industry has a much lower bad debt experience than the banking industry.

If the complainant allowed bad debt losses up to one-half of one percent, the respondent could be allowed bad debt losses up to $55,000 for the base year ($11,000,000 x .005; Appeal, pp. 10-11). That would be entirely unreasonable in the stockyards industry.

V. *Pasture Rent*

The $300 rent expended by respondent for a pasture about 5 or 10 miles distant from the auction market was excluded by complainant because complainant determined that the pasture was not used and useful for auction market purposes (Finding 11, *supra*).

The original determination by the complainant's auditor, Ralph R. Hammond, to remove the $300 pasture rent was made after he talked to Mr. Giles Lowery and learned how far away the pastureland was located (Tr. 95-97). At the oral hearing, Mr. Hammond's conclusion was supported by the testimony of William J. Jones, complainant's stockyards appraisal expert. Mr. Jones testified that only 6½ acres of land were used and useful for respondent's stockyards business, including the holding of market support livestock (Tr. 249-272). In Mr. Jones' opinion, even the 16 acres of pastureland adjacent to the respondent's market were not used and useful for respondent's stockyards business, including the holding of market support livestock (Tr. 262-263). There is no testimony on behalf of the respondent to the contrary. Accordingly, the record in this case compels the conclusion that complainant correctly removed the $300 pasture rent from respondent's expenses.

Although there is no testimony in this case to the effect that the rented pastureland in question was actually used during the base period to hold market support livestock, even if such pastureland had been used in that fashion during the base period, the $300 pasture rent would properly be allowed only if such additional land were reasonably necessary to hold such market support livestock. There is nothing in the record in this case to contradict complainant's expert testimony that the rented pastureland was not used and useful by the respondent stockyards.

VI. *Trucking and Hauling*

The complainant removed from respondent's expenses $9,370.78 expended for trucking and hauling services because the respondent's records were inadequate to show that consignors of the market had benefited from the trucking and hauling (Finding 12, *supra*).

The respondent contends that the trucking and hauling expenses were incurred in connection with trucking market support livestock (Appeal, pp. 11-12). Trucking expenses for market support livestock are a legitimate stockyards expense (Tr. 98-99, 102-103). However, Mr. Hammond, the complainant's auditor, testified that he could not ascertain from the respondent's records that any of the excluded trucking expenses were incurred in connection with respondent's market support livestock (Tr. 15-17, 98-105).

There is no testimony in the present record to establish that the $9,370.78 in question was expended for trucking market support livestock. In these circumstances, the complainant properly disallowed the $9,370.78 trucking expense.

On October 4, 1972, three months after the beginning of the base year involved in this proceeding, the respondent stockyards was ordered to "keep accounts, records and memoranda which fully and correctly disclose all transactions involved in its business as a market agency subject to the Act" (*In re Giles Lowery Stockyards, Inc.*, 31 Agriculture Decisions 1257, 1261). If the respondent had complied with that Order, and if the $9,370.78 was spent for trucking market support livestock, respondent would have had no difficulty establishing this item as a legitimate expense. However, respondent did not comply with the Order to keep records fully and correctly

disclosing all transactions involved in its stockyards business and respondent did not establish at the hearing that the $9,370.78 was spent for trucking market support livestock.

In this case, it is particularly inappropriate to assume that the trucking expenses in question were in connection with market support livestock at respondent's Lufkin, Texas, stockyards inasmuch as Giles Lowery is also engaged in the livestock business at Bay City, Texas, and as a livestock dealer. But even if Giles Lowery had no other livestock business, respondent still would have to have records to prove the nature of its expenses, including trucking expenses.

The respondent contends that the "testimony reflects that $3 per animal is or should be a reasonable amount for trucking and hauling ([Tr.] 102-103)." But the record does not support respondent's contention in this respect. When Mr. Hammond was asked what the average cost of hauling market support livestock was, he replied (Tr. 102):

> A. It depends on where it's being hauled and what distance. I mean, it varies. I suppose you could get two or three hauled for $5 to some market and maybe two or three hauled for 25 to a further market. I don't know.

Specifically, when asked whether $3 per animal is an unreasonable amount for trucking, he replied (Tr. 103):

> I don't know. I don't know what the going rate is for hauling cattle in this area.

Hence there is nothing in the record to show the average cost of hauling market support livestock. Moreover, there is nothing in the record to show that the $9,370.78

was spent for trucking respondent's market support livestock.

Presumably, the respondent is now maintaining proper records with respect to its market support livestock. If the respondent requests increased rates based upon changed circumstances since the base year, presumably respondent will be able to justify any legitimate trucking expenses incurred in connection with market support livestock. In such circumstances, respondent's failure to verify its alleged expenses in connection with trucking market support livestock during the base year would not adversely affect respondent.

VII. *Caretaker's House*

The complainant disallowed as legitimate expenses the depreciation expense and utility expense, totaling $531.99, associated with a house adjacent to the auction market which respondent furnishes rent free to Mr. Leonard Miller for his own use and the use of his family (Finding 14(d)). The house is a modest frame house that would rent for about $60 a month (Tr. 109, 111).

The record in this case does not show that Mr. Miller's total compensation of $250 per week plus free rent is unreasonable considering all of his duties, including being a caretaker seven days a week at the market. Hence the complainant erred in disallowing the expenses incident to this house.

The complainant's objection to the house expenses seems to be in the nature of a conceptual objection to allowing expenses incident to any house used by Mr. Miller's family. But that viewpoint is too narrow. There is nothing improper in furnishing a house adjacent to the stockyards to a caretaker and his family so that he may effectively

perform his duties for the market. The expenses incident to the house should be allowed as reasonable expenses unless it is determined that the total compensation to the caretaker is unreasonable. The record in this case does not support the position that Mr. Miller's total compensation, including the rental value of the house, is unreasonable.

Although this increases the respondent's reasonable revenue requirements by $531.99, the complainant's proposed tariff would produce several thousand dollars more than the reasonable revenue requirements determined by complainant (Finding 27, *supra*). Accordingly, the complainant's error as to this item would not result in a change in complainant's proposed tariff.

VIII. *Market Support*

In determining the total revenue received by respondent stockyards, the complainant included approximately $16,648.63 in commissions paid by the consignors in connection with livestock purchased by the market for market support (Finding 26, *supra*). The respondent contends that such commissions should not be included as part of its total revenue (Appeal, pp. 13-14).

Market support purchases by a market do not occur because the market has guaranteed the price at which the livestock will be sold. It is unlawful for a stockyards to guarantee the price at which consigned livestock will be sold (9 CFR 201.64). However, some markets, including the respondent, bid on livestock, at times, hoping to stimulate further bids; but if no further bids are received, the market becomes the purchaser of the livestock.

The complainant regards the commissions paid by the consignors in connection with such market support purchases by respondent as revenue received by the market.

For example, if a farmer consigns a cow to a stockyards for sale and the market bids $300 for market support purposes, and becomes the owner of the cow, assuming that the commission on the sale of such cow is $5, the market pays the farmer the net proceeds of $295, and the complainant regards the stockyards as having received $5 commission from the consignor.

The accounting by the market to the consignor is the same irrespective of whether the market buys the animal for market support or whether a third party buys the animal from the consignor, except that the name of the purchaser would be different. For example, in the hypothetical example referred to in the preceding paragraph, the market would send a check to the farmer for the net proceeds ($295), and the market's accounting would show that the market received a $5 commission from the farmer. The identical accounting would be made if a third party bought the cow, even if he subsequently failed to pay for the cow.

Under the Act, stockyards act as the agent of the seller. Hence the seller pays the commission—not the buyer. In practice, rather than paying the gross proceeds from the sale of livestock to the consignor and then having the consignor pay the commission and other charges, if any, to the stockyards, a single check for the net proceeds is sent by the market to the consignor. Specifically, the regulations provide, in this respect (9 CFR 201.43(a)):

> § 201.43 *Payment and accounting for livestock and live poultry.*
>
> (a) *Market agencies and licensees to make prompt accounting and transmittal of net proceeds.* Each market agency shall, before the close of the next business day following the sale of any livestock consigned to it

for sale, transmit or deliver to the consignor or shipper of the livestock, or his duly authorized agent, in the absence of any knowledge that any other person, or persons, has any interest in the livestock, the net proceeds received from the sale and a true written account of such sale, showing the number, weight, and price of each kind of animal sold, the name of the purchaser, the date of sale, the commission, yardage, and other lawful charges, and such other facts as may be necessary to complete the account and show fully the true nature of the transaction.

In practice, the market frequently or usually sends the check for the net proceeds to the seller before the purchaser has paid for the livestock. But even before the market has been paid by the buyer, and even if the market is never paid by the buyer, the market receives a commission from the seller when it sends a check for the net proceeds to the seller just as realistically as if the market had sent a check to the seller for the full purchase price and the seller had then sent a check back to the market for the commission.

Two eminently qualified witnesses expert in accounting principles testified for respondent that when the market buys livestock for market support, it receives no income or profit and, therefore, no revenue in the transaction (Tr. 317-328, 330-335). Reliance was placed upon § 4010 of the accounting principles adopted by the Accounting Principles Board, American Institute of Certified Public Accountants, stating that "profit is deemed to be realized [when] a sale in the ordinary course of business is effect[ed] unless the circumstances are such that the collection of the sales price [is] not reasonably assured" (Tr. 321). One of the respondent's experts testified as to that accounting principle (Tr. 321-322):

Well, the way that I would fit this quote into this situation is that at the time the market buys a market support animal there has been no sale. There's no sale to the consignor, but we're not accounting for the consignor. We're accounting for the barn or Lufkin Lowery market.

All there has been is a purchase. There has not been a sale.

And according to everything that I have ever been taught about accounting is that you cannot recognize profit when you buy something.

You can put it on the books at what it cost you. This is akin to what is known—to a purchase what is known in accounting terminology as a purchase discount.

Q. You're stating that, then, this is not a revenue to the barn because the barn has not, in fact, earned anything?

A. That's what I'm stating.

Q. When they buy that cow.

A. Yes, sir.

Q. The records submitted by the Packers and Stockyards Administration erronously suggest that the barn has, in fact, made a commission on itself; is that not correct?

A. Yes.

The error in the conclusion by the respondent's expert witnesses results from their failure to recognize or give weight to the fact that livestock commissions are paid by the seller—not the buyer. Under their view, when the market buys livestock for market support, no commission is paid by the seller. But that would violate the Act.

It is settled that it is a violation of the Act for a stockyards to fail to charge a commission to any seller or to give a seller a reduced commission (see, *e.g.*, *In re Sebastian Scirpo*, 27 Agriculture Decisions 444, 446-448 (1968); *In re Rock Port Sale Pavilion, Inc.*, 25 Agriculture Decisions 477, 479-480 (1966); *In re Amsterdam Livestock Sales, Inc.*, 25 Agriculture Decisions 997, 999-1000 (1966); *In re Roy Taylor*, 24 Agriculture Decisions 109, 110-112 (1965); *In re Winfield Livestock*, 24 Agriculture Decisions 609, 611-612 (1965); *In re Lusk Livestock Commission Co.*, 24 Agriculture Decisions 1074, 1076-1078 (1965); *In re Wheatland Livestock*, 24 Agriculture Decisions 1079, 1080-1081 (1965); *In re Southern Livestock Auction Co.*, 24 Agriculture Decisions 1474, 1479-1482 (1965)). Accordingly, all sellers, including sellers whose livestock are bought by the market for market support, must pay a commission. Since a commission is paid by the seller irrespective of whether the market or a third party buys the livestock, a commission is received by the market from the consignor in every transaction, including market support purchases.

The situation insofar as commissions are concerned is no different when the market buys the animal for market support than when a third party purchaser fails to pay for the livestock. In either case, the seller—not the buyer—pays the commission. Mechanically, the payment is made by the seller receiving a check for the net proceeds of the livestock instead of having a check for the gross proceeds issued to the seller and then having the seller immediately pay the commission to the stockyards.

In many cases, it would make no difference whether the complainant's accounting treatment of commissions in connection with market support purchases is followed or the respondent's approach is followed. Ordinarily, the revenue received as selling commissions from the sellers

in connection with market support purchases would be offset by the complainant's allowance for business getting and maintaining expenses, including market support losses. But in this case, the respondent's records were inadequate to prove market support expenses except in the amount of $4,063.59. Hence the complainant's allowance for respondent's business getting and maintaining expenses, including market support losses, was less than the revenue received by respondent as commissions from the sellers in market support transactions during the base year (Findings 15 and 19, *supra*).[23]

It may be that the complainant's treatment of commissions received in market support transactions is different from that of the Internal Revenue Service, but the principles of accounting acceptable by the Internal Revenue Service are not necessarily appropriate for rate regulation purposes (Tr. 143-144). As recognized in an opinion of the Accounting Principles Board, American Institute of Certified Public Accountants, which appears in the Journal of Accountancy, December 1962, page 67:

> 1. The basic postulates and the broad principles of accounting comprehended in the term "generally

23. Even where a market's records are adequate to prove all of the market support expenses, the complainant's allowance for business getting and maintaining expenses, including market support losses, does not exceed 25¢ per animal unit handled during the year (Finding 19, *supra*) and, therefore, to the extent that market support losses exceed the 25¢ limit, it would make a difference whether the complainant's or respondent's accounting method is followed. Under respondent's proposed accounting treatment, complainant's control over the amount of allowable market support losses would be lessened. For example, in this case, assuming that respondent's records as to market support losses were adequate to prove respondent's alleged losses, under respondent's accounting treatment, $16,648.63 would be subtracted not only from respondent's revenue received, but, also, from respondent's expenses. Hence, under respondent's theory, complainant would have no control over whether respondent's business getting and maintaining expenses exceeded 25¢ per animal unit.

accepted accounting principles" pertain to business enterprises in general. These include public utilities, common carriers, insurance companies, financial institutions, and the like that are subject to regulation by government, usually through commissions or other similar agencies.

2. However, differences may arise in the application of generally accepted accounting principles as between regulated and nonregulated businesses, because of the effect in regulated businesses of the ratemaking process, a phenomenon not present in nonregulated businesses. Such differences usually concern mainly the time at which various items enter into the determination of net income in accordance with the principle of matching costs and revenues.

In the stockyards industry, since the commission is paid by the seller—not the buyer—and since all sellers are required by law to pay the commission, complainant's accounting practice for ratemaking purposes, which includes in a stockyard's total revenue commissions paid by the sellers in connection with livestock bought by the market for market support, is manifestly correct.

IX. *Return on Buildings and Equipment*

The complainant included an allowance of $2,398.60 for the return on respondent's buildings and equipment during the base period. This allowance was computed on the basis of 8% of the original cost, when first dedicated to the public use, of the buildings (including improvements) and equipment, less depreciation (Finding 20, *supra*).

This is the only allowance under complainant's auction market rate analysis which is based on a rate of re-

turn times value. Prior to about 1969, the allowance for land was computed by multiplying the rate of return times the value of the land, but the allowance for land is now computed on the basis of the number of animal units handled at the market, which, in this case, resulted in an allowance more than three times larger than would have been determined under the pre-1969 formula (Finding 21, *supra*).

The respondent challenges the complainant's use of original cost, less depreciation, and also the 8% rate of return (Appeal, pp. 5-7, 14-16). The value and rate of return must be considered as a unit since the complainant's allowance is obtained by multiplying the valuation of the buildings and equipment times the rate of return; and whenever two figures are multiplied together, the identical increase in amount can be accomplished by applying the same percentage increase to either of the factors which are multiplied together.

For example, if the value of a building is $100 (using unrealistically small figures to illustrate the point), and the rate of return is 6%, the allowance would be $6. If, because of inflation or any other reason, complainant wanted to increase the allowance by one-third, *i.e.*, to $8, the increase could be effected by increasing the value of the building by one-third (to $133.33), which would result in an $8 allowance at 6% ($133.33 x .06); or the value of the building could be left at $100, and the rate increased by one-third (to 8%), which would result in an allowance of $8 ($100 x .08). Since any desired increase in the allowance can be produced either by increasing the valuation of the building or by increasing the rate of return, both factors must be considered simultaneously to determine whether the result is reasonable.

A. *Original Cost, Less Depreciation*

The respondent criticizes the complainant's use of original cost when first dedicated to the public use, less depreciation, for several reasons.

One objection is that this factor constantly diminishes, as depreciation is deducted each year, and, therefore, in time the allowance will allegedly become unreasonably small. The short answer to this objection is that the full amount of the depreciation deducted by complainant each year is allowed as an expense and, therefore, the full amount of such depreciation is returned to the stockyards owner by the ratepayers each year. This return of equity capital to the stockyards owner, resulting from each year's depreciation allowed as an expense, is in addition to the 8% return on buildings and equipment. (I was unaware until late in the oral argument in this case that the return of equity capital each year, *i.e.*, by allowing as an expense each year's depreciation, is in addition to the 8% return allowed on the stockyard owner's buildings and equipment.)

Specifically, during the base year, the respondent's depreciation on its buildings and equipment was $3,383.01 (Comp. Ex. 7). That entire amount of depreciation, $3,383.01, is included in the respondent's expenses of $203,846.57 shown on line 1 of Figure 1; and $3,383.01 is included in the respondent's Adjusted Expenses of $125,764.37 shown on line 22 of Figure 1, *supra*.

Obviously, if a portion of a stockyard owner's original investment is returned to him each year, he should not earn a return each year on the full amount of his original investment. His return should be on his original investment less that portion of his original investment which has been returned to him.

To use a hypothetical example, if a stockyards owner built a building in 1950 for $100,000, and depreciated it over 25 years at the rate of $4,000 per year, in the first year, $4,000 would be returned to him by the ratepayers (since $4,000 depreciation would be included in the market's expenses) and, in addition, he would earn the complainant's rate of return on $96,000. For the second year, he would receive another $4,000 from the ratepayers (as a result of the second year's depreciation included in the market's expenses), making a total of $8,000 of his equity capital returned by the ratepayers during the first two years, and he would earn the complainant's rate of return during the second year on $92,000.

If the stockyards owner in this hypothetical example wanted to continue to earn the complainant's rate of return on the full amount of his original investment, he would merely have to invest the equity capital returned to him each year at the same interest rate as complainant's rate of return.

When the mechanics of complainant's rate formula are fully understood, it is obvious that respondent has no legitimate complaint because of the steady decline in the value of its buildings and equipment.

The respondent also objects to the complainant's use of original cost when first dedicated to the public use, less depreciation, because that method does not take into account any increased price paid by a new owner of the stockyards.

However, a purchaser of a stockyards is buying a regulated enterprise and, therefore, he should pay no more for the enterprise than he is willing to pay on the basis of the rates that the complainant allows. There is ample precedent in the field of public utility ratemaking cases

to support complainant's view that an increase in rates should not be permitted merely because a new owner purchases the property. See, *e.g.*, *Re*: *Jefferson County Sewer Co.*, 87 PUR 3d 392, 397 (1971); *Re*: *Canadian Utilities, Ltd.*, 80 PUR 3d 385, 399 (1969); *Pennsylvania Pub. Utility Comm.* v. *Penn. Power & Light Co.* (15559 *et al.*, Nov. 20, 1956; not reported, but digested in 16 PUR 3d 592); *Donnelley* v. *Consolidated Water Co. of Utica*, 3 PUR (NS) 173, 183 (1933).

The respondent's most troublesome objection to the complainant's use of original cost, less depreciation, is that this factor does not rise with inflation. This objection warrants extensive discussion, extending to the end of this subsection.

First, even if the return on a stockyard owner's investment did not fully keep pace with inflation, he would be no worse off than many others who have invested in stocks, bonds and savings and loan associations. Bonds purchased many years ago yield the same return, year after year, despite inflation (and, if sold prior to maturity, would be heavily discounted). Dividends from many common stocks have not kept pace with inflation (and many stocks have declined sharply in value). The complainant's 8% rate of return is much higher than the rate of return on many of such bonds and stocks bought years ago; and is at least as high, if not higher, than the rate of return presently available at many savings and loan associations. Hence even if the return on a stockyard owner's investment did not increase commensurately with inflation, he would be as well off as many other investors.[24]

24. A minor consideration is that, in a very real sense, inflation is, in part, a form of indirect taxation by Congress; and stockyard owners should bear some part of the burden of that indirect taxation.

The most important consideration as to this issue is the fact that an auction market owner's return on his buildings and equipment is a very minor part of his total return from the auction stockyards; whereas in the case of other public utilities, the return on buildings and equipment is a large part of the owner's total return. Hence it is nowhere near as important to auction market owners as to owners of other public utilities that the value of buildings and equipment keep pace with inflation.

For example, complainant's rate analysis allowed Giles Lowery to receive during the base year $48,619.58 more than reasonable expenses and depreciation,[25] of which only $2,398.60 thereof, or 4.9% ($2,398.60 ÷ $48,619.58), resulted from the allowance for the return on respondent's buildings and equipment.

Even if the $22,715.20 allowance for operating margin is excluded from consideration, Giles Lowery's return over expenses would still be $25,904.38 ($48,619.58 – $22,715.20), and the allowance for the return on respondent's buildings and equipment is only 9.3% of that amount ($2,398.60 ÷ $25,904.38).

Hence it is clear that the revenue derived from the return on an auction market owner's buildings and equipment is a small part of his total return over expenses, and is negligible compared to the return on buildings and equipment received by the owners of other public utilities.

25. This consists of allowances of $15,839.40 for a working owner; $3,549.25 for owner's management; $709.85 for interest on working capital; $2,398.60 for return on buildings and equipment; $3,407.28 for use of land; and $22,715.20 for operating margin (Fig. 1, *supra*). Some part of the "operating margin" might, of course, be needed for contingencies, thereby reducing the money available to the owner. But, on the other hand, the money available to the owner would increase substantially if his livestock volume increased significantly. It is not complainant's practice to monitor future volume increases, resulting in future increased income, until the auction owner seeks a future rate increase.

In these circumstances, the livestock auction market industry would not be seriously affected even if that portion of the owner's total income resulting from the return on the auction market's buildings and equipment did not increase in any manner with inflation. It could reasonably be expected that the auction market industry would continue to survive and be economically healthy.

The foregoing circumstances, peculiar to the livestock auction market industry, must be considered in connection with the respondent's view with respect to the valuation of auction market buildings and equipment.

Respondent urges the adoption of a formula for determining the value of auction market buildings and equipment found in *Railroad Commission of Texas* v. *Houston Natural Gas Corp.*, 289 S.W.2d 559, wherein the Texas Supreme Court endorsed a "reasonable balance" between original cost less depreciation and reproduction cost new less deterioration and obsolescence. This would, of course, require a determination as to the reproduction cost new of respondent's buildings and equipment.

Complainant's position is that the reproduction cost new less depreciation method of valuation of buildings and improvements and movables is speculative, unreliable, and has no real relationship to the actual experience of stockyards. It argues that the most reliable, most stable, and most equitable basis for the valuation of such property is the original cost of the property when first dedicated to the public use.

Valuing respondent's buildings and equipment at original cost when first dedicated to the public use minus depreciation conforms to the rationale in *In re St. Paul Union Stockyards Company*, 21 Agriculture Decisions 1216 (1962). In that case, the Judicial Officer adopted in principle the

original cost method of valuation (21 Agriculture Decisions at 1238-1272).[26] The Judicial Officer explained the bases for favoring original cost, less depreciation, over any formula based on reproduction cost new or trended original cost as follows:

> 53. * * * The Court of Appeals of Maryland stated in the case of *Chesapeake & Potomac Tel. Co.* v. *Public Service Commission*, 93 A.2d 249, 254 (1952), that:
>
> > Estimates of reproduction cost are conjectural at best, not merely because they rest on opinion, but for the obvious reason that probably no plant would ever be reproduced in its present form. Even the physical structures to replace the old would be designed, so far as possible, to compensate in efficiency and convenience for the higher construction costs.
>
> 54. The court quoted from an earlier opinion of the Maryland Public Service Commission (84 PUR NS 175, 183 (1950):
>
> > In short, it is a theoretical reproduction of something which, as a practical matter if it did not exist, would not be produced in its present form and locations. As this highly theoretical process has questionable probative value in times of normal and stable economy it has even less value at the present time.

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26. The *St. Paul* case involved a terminal stockyards rather than an auction stockyards, and because of peculiarities applicable to the facts of that particular terminal stockyards (which would not apply to any auction market today), the Judicial Officer used a "split inventory" method of valuation which departed to some extent from original cost, but which totally avoided any determination of reproduction cost new (21 Agriculture Decisions at 1238-1285).

55. The Tennessee Railroad and Public Utilities Commission in the case of *Re Southern Bell Telephone & Telegraph Company* (100 PUR NS 33, 36 (1953)) stated with reference to reproduction cost estimates that:

> In brief, it constitutes an attempt to estimate the reproduction cost of old property at present day prices of material and labor. Such proof is highly conjectural, speculative, and unrealistic. The company would hardly think of replacing its old facilities with precise counter parts, or at their original locations. Technological progress and the growth of the industry have rendered obsolescent a substantial portion of these facilities. While present-day replacement may be somewhat more costly to install, they are more efficient and economical in operation (21 Agriculture Decisions at 1246-1247).

* * *

81. In his concurring opinion in *St. Joseph Stock Yards Co.* v. *United States,* 298 U.S. 38 (1936), Mr. Justice Brandeis presents convincing examples of the magnitude of the task imposed upon regulatory agencies and the courts in applying the rule of *Smyth* v. *Ames* [169 U.S. 466, which required consideration, *inter alia,* of reproduction cost new] — the massive records, the delays, the excessive cost, the time consumed by all participants, and the obstacles encountered. The present proceeding is another classic example of the futility of trying to apply the reproduction cost valuation theory and prescribe rates with reasonable promptness (21 Agriculture Decisions at 1258-1259).

* * *

96. The trended cost theory is even more conjectural, speculative, hypothetical, and unrealistic than the reproduction new theory. It has the same basic infirmities as the reproduction new theory, except to a greater degree. The United States Supreme Court long ago condemned the trended cost theory. In the case of *West* v. *Chesapeake and Potomac Telephone Company of Baltimore,* 295 U.S. 662, 674 (1935), it was held that: "* * * the method was inept and improper, is not calculated to obtain a fair or accurate result, and should not be employed in the valuation of utility plants for rate making purposes."

97. In the *Hope* case the Federal Power Commission condemned the trended cost estimate as having no "probative value" since it was "not founded in fact," was "basically erroneous," and produced "irrational results." The Commission held that (44 PUR NS at 9): "The reproduction cost studies and the so-called trended 'original cost' studies were the typical, hypothetical conjectures which have plagued rate regulation for more than forty years" (21 Agriculture Decisions at 1263).

* * *

101. We similarly approve of the net capital investment or original cost method of valuation for the reasons expressed by the hearing examiner and demonstrated in the record of this proceeding. As stated by Mr. Justice Brandeis in his dissenting opinion in *Southwestern Bell Telephone Company* v. *Public Service Commission of Missouri, supra,* at p. 290: "The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon the capital so invested

> the Federal Constitution guarantees to the utility the opportunity to earn a fair return. . . ." Moreover, an original cost rate base is determined from facts and not theories, estimates or speculations and the fixing of such a rate base at any time simply involves the adding of capital expenditures and deducting retirements and depreciation as shown by accounting records subsequent to any previous date when the rate base was fixed. The original cost method avoids expensive appraisals and the controversies incident thereto (21 Agriculture Decisions at 1266).

If the complainant were required to determine reproduction cost new each year for about 2,000 stockyards, its present rate staff of four professional employees would have to be increased to at least several hundred professional employees. Although administrative difficulties should not be controlling where vital interests are at stake, as shown above, no vital interest is at stake here. Moreover, as shown in the quoted material above, any use of reproduction cost new involves a determination which is highly conjectural, unrealistic and lacking in probative value.

In *Federal Power Commission* v. *National Gas Pipeline Company,* 315 U.S. 575, the Court sustained an order of the Commission under the Natural Gas Act. In discussing the scope of judicial review of rates prescribed by the Commission, the Court held (315 U.S. at 586):

> The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.

In a concurring opinion in that case by Mr. Justice Black, Mr. Justice Douglas and Mr. Justice Murphy, it is stated (315 U.S. at 602-606):

> While the opinion of the Court erases much which has been written in rate cases during the last half century we think this is an appropriate occasion to lay the ghost of *Smyth* v. *Ames,* 169 U.S. 466, which has haunted utility regulation since 1898. That is especially desirable lest the reference by the majority to "constitutional requirements" and to "the limits of due process" be deemed to perpetuate the fallacious "fair value" theory of rate making in the limited judicial review provided by the Act.
>
> * * *
>
> The rule of *Smyth* v. *Ames* as construed and applied, directs the rate-making body in forming its judgment as to "fair value" to take into consideration various elements—capitalization, book cost, actual cost, prudent investment, reproduction cost. * * * The risks of not giving weight to reproduction cost have been great.* * * The havoc raised by insistence on reproduction cost is now a matter of historical record.
>
> * * *
>
> As we read the opinion of the Court, the Commission is now freed from the compulsion of admitting evidence on reproduction cost or of giving any weight to that element of "fair value."

In *Federal Power Commission* v. *Hope Gas Co.,* 320 U.S. 591, the Court again considered an order of the Fed-

eral Power Commission prescribing rates under the Natural Gas Act. The Commission established the rate base on the basis of the "actual legitimate cost" of the property involved less depreciation (320 U.S. at 596). Evidence of the cost of reproduction new was given no weight by the Commission on the grounds that it was "not predicated upon facts" and was "too conjectural and illusory to be given any weight" (320 U.S. at 597). The Commission also refused to give any "probative value" to "trended 'original cost'" because it was "not founded in fact," was "basically erroneous," and produced "irrational results" (320 U.S. at 597).

Previously, the Court of Appeals had reversed the Commission's order (134 F.2d 287), and among the grounds for reversal were: (1) that the rate base should reflect the "present fair value" of the property; (2) that the Commission should have considered reproduction cost and trended original cost; and (3) that "actual legitimate cost" (prudent investment) was not the proper measure of "fair value" where price levels had changed since the investment.

The Supreme Court reversed the Court of Appeals, stating (320 U.S. at 602):

> We held in *Federal Power Commission* v. *Natural Gas Pipeline Co., supra,* that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its ratemaking function, moreover, involves the making of "pragmatic adjustments." * * * And when the Commission's order is challenged in the courts, the question is whether that order "viewed in its entirety" meets the requirements of the Act. * * * Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling. * * * It is not

> theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.

For the reasons set forth above, it is concluded that complainant's use of original cost when first dedicated to the public use, less depreciation, is not only lawful, but is highly desirable for ratemaking purposes involving the livestock auction market industry.

If the auction market owner's total income is to increase with inflation, as it must to the extent necessary to insure that sufficient markets will remain economically viable to handle the available volume of livestock, the increase should be accomplished in some manner[27] which is not as time-consuming, burdensome and administratively unworkable as respondent's proposal, which would require a determination of the reproduction cost new of the market's buildings and equipment.

B. *Rate of Return*

The complainant used a rate of return of 8%, which was applied to the value of respondent's buildings and equipment (Finding 20, *supra*).

There is no precedent, administrative or judicial, which gives any meaningful guideline for determining the rate of return to be applied to the value of a livestock auction market's buildings and equipment.

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27. For example, by increasing the rate of return over that allowed several years ago; increasing the return previously allowed on land; providing for a very liberal operating margin; or providing for a very liberal allowance for a working owner (in this case, over $10,000 more than a hired employee would receive for the "starter" function performed by Giles Lowery, *see, supra*).

The complainant cites as a "guide" to determining the rate of return on buildings and equipment the case of *In re St. Paul Union Stockyards Company, supra,* 21 Agriculture Decisions 1216, 1291 (1962), in which the Judicial Officer stated:

> We believe we shall discharge our obligations to the investor and treat the rate payer fairly if we provide revenues sufficient for the company to pay (a) its actual operating expenses prudently and economically incurred; (b) an annual charge for depreciation based upon the expected life of the properties; (c) taxes; (d) interest on its debt at the rate actually paid; (e) a reasonable dividend on its outstanding stock; and (f) something to be added to the surplus to enable the company, under good management, to maintain and support its credit.

However, that case involved a terminal stockyards, which, as shown above, is quite different from an auction stockyards. In the *St. Paul* case, *supra,* the rate base, consisting of land, buildings, equipment and working capital, was $5,118,810 (21 Agriculture Decisions at 1315). Buildings and equipment alone were valued at $3,294,167, or 64.4% of the total rate base (*ibid.*). The Judicial Officer, applying the criteria quoted in the preceding paragraph, concluded that the "reasonable rate of return which the respondent is entitled to earn on the rate base, after an allowance for all reasonable operating expenses, depreciation, and income taxes, is 7.75 percent" (*ibid.*). The terminal stockyard owners' income resulted from applying the 7.75% rate of return to the $5,118,810 rate base (*ibid.*).

But as shown above, only 4.9% of Giles Lowery's income from the auction market depends on the rate of

return (or 9.3% if the operating margin is not considered). Hence the rate of return was decisive as to the total income of the stockyard owners in the *St. Paul* case, but is decisive as to only a very small part of an auction market owner's income. Hence the six criteria quoted above from the *St. Paul* case provide no meaningful guideline as to the rate of return to be applied to the value of an auction market's buildings and equipment. If relevant at all to an auction market, the six criteria would be useful only in determining whether the auction owner's total income from the stockyards was just and reasonable.

To the extent that an auction market owner used borrowed funds to pay for the buildings and equipment, complainant should give some consideration to the forth criterion quoted above, *viz.,* "interest on its debt at the rate actually paid." In this case, the respondent corporation borrowed funds from the Small Business Administration at 8% annual interest (Tr. 89-92). The complainant's 8% rate of return, therefore, allows respondent to service its debt.

The complainant also cites for guidance as to the rate of return to be applied to the value of the respondent's buildings and equipment the rate of return allowed in other regulated industries. This also is a factor that should be given some consideration. Recent rate cases show wide variations in the rates of return allowed. The majority, however, are in the range of 8%. The following table of rate cases was cited by the Chief Administrative Law Judge as representative (Initial Decision, p. 28):

Company	*Citation*	*Rate of Return (%)*	*Date of Decision*
Utilities & Industries Corp.	100 PUR 3d 467, 474	7.57	8-9-73
South Central Bell Tele. Co.	100 PUR 3d 502, 504	6.93	8-21-73
Union Light, Heat & Power Co.	100 PUR 3d 518, 522	8.67	8-13-73
Pacific Northwest Bell Tel. Co.	100 PUR 3d 82, 103	8.93	7-14-73
Capital City Water Co.	100 PUR 3d 124, 126	7.76	6-1-73
Kansas-Nebraska Natural Gas Co., Inc.	100 PUR 3d 129, 138	8.5	7-26-73
New England Tel. & Tel. Co.	100 PUR 3d 189, 199	8.93	6-25-73

The complainant's 8% rate of return is, therefore, consistent with the rates of return allowed in other regulated industries, and is just and reasonable in the circumstances of this case.

Respondent makes much of the case law requirement that a rate of return for a regulated utility should be sufficient to "attract" capital. The point is not well-taken, however, because, as shown above in the first section of this Decision, the ability to attract capital is not a proper consideration in an auction stockyards rate case. But even if it were, the rate of return applied to the value of an auction market owner's buildings and equipment determines such a negligible portion of his total income that it could not be a serious factor in attracting capital.

Respondent argues that a "small stockyard like this company has a greater risk and needs a greater return than other utilities" (Brief, Finding 14). However, no evidence was introduced to show an actual greater risk in the stockyards industry, whereas evidence was introduced to show that investment in the stockyards industry is a relatively safe investment (Tr. 199-200). Moreover, as shown above, since the rate of return affects such a negligible portion of an auction owner's total income, even if the stockyards industry were not a relatively safe investment, the rate of return could not have much of an effect on the situation.[28]

X. *Per-Head-Weight Tariff Schedule*

The complainant's proposed tariff is based on a per-head-weight schedule, as opposed to the valuation type tariff presently in effect at the respondent's market and at neighboring markets (Finding 27, *supra*). About 800 of the 2,000 auction markets in the United States use a per-head-weight schedule such as that proposed by complainant, and about 1,200 use a valuation type tariff. Both types of tariffs are used in Texas, but respondent's nearby competitors use valuation type tariffs (Tr. 173-174).

The respondent admits that the per-head-weight schedule "would probably be better for the livestock exchanges if they used it" (Appeal, p. 17), but respondent contends that it will not work for its market while the other nearby markets operate on valuation tariffs. The

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28. As shown above, the complainant erroneously excluded the book value of the caretaker's house ($2,636.53) from the value of respondent's buildings. At 8%, the value of the house would permit an additional $210.92 in income. But since the complainant's proposed tariff will produce several thousand dollars more than respondent's reasonable revenue requirements (Finding 27, *supra*), no change in complainant's proposed tariff is required.

respondent argues that consignors would take their animals to other auction markets when the price of animals is low because the commission charge under valuation tariffs would be less than at respondent's market. However, the respondent's fear is without any reasonable basis in fact since the price of cattle would have to drop almost in half (below $12.50 per hundredweight) before the commission charge at a competing market with a valuation tariff would be lower than respondent's commission charge. That is highly unlikely.

Complainant contends that the valuation tariffs presently in effect are illegal under the Act inasmuch as they are discriminatory. Under the valuation tariffs, different commissions are charged to different consignors based on the value of the livestock, but the value of the livestock has no relation to the cost of service. Hence complainant contends such valuation tariffs are discriminatory (Tr. 175, 227-228) and, therefore, illegal (7 U.S.C. 206, 211).[29] Complainant plans "doing something [about the illegal valuation charges] as soon as we determine the approach that we want to take on the problem" (Tr. 176).

It is not necessary to express any opinion in this case as to the complainant's view that all livestock valuation tariffs are discriminatory, and, therefore, illegal. The record in this case does not consider whether the value of the selling service varies with the price of the animal, which might be argued as a basis for supporting valuation tariffs

29. Complainant's view that the value of the livestock has no relation to the cost of service (Tr. 175, 227-228) is supported by one of the leading livestock marketing authorities, Dr. Stewart H. Fowler, Professor of Animal Husbandry, Louisiana State University, who states: "It appears that per head charges for marketing services come closer to actual costs than charges based on a percentage of the gross sales value. This is because the cost of handling the same species is much the same regardless of the value of the animal" (Fowler, *The Marketing of Livestock and Meat* (1961), p. 294).

(*cf., Tagg Bros.* v. *United States*, 280 U.S. 420, 441). But in any event, per-head tariffs are certainly permitted, whether or not required, by the Act, and there is no reasonable basis for respondent's fear that any adverse effect might result from using a per-head tariff. Hence complainant's proposed per-head tariff is reasonable, lawful and supported by the record in this case.

CONCLUSION

For the foregoing reasons, the respondent's challenges to complainant's ratemaking procedure are rejected. Complainant's ratemaking procedure is reasonable and appropriate for determining whether auction market rates are just and reasonable.

But even if it were to be assumed for the purposes of argument that the complainant's procedure were defective with respect to one or more particular items, "it is the result reached not the method employed which is controlling." *Federal Power Commission* v. *Hope Gas Co.*, 320 U.S. 591, 602. In this case, the result reached is that respondent is entitled to charge rates producing $184,824.58 (Finding 25, *supra*). Whether that total sum is adequate is the only relevant consideration in determining whether the complainant's proposed rates are just and reasonable. It is irrelevant whether complainant's determinations or allowances for particular items are too low provided the end result—$184,824.58—is adequate.

As shown above in the discussion under the subsection relating to Original Cost, Less Depreciation, the total revenue of $184,824.58 provides Giles Lowery[30] with

30. For regulatory purposes, Giles Lowery and his wholly owned and controlled corporation, *i.e.*, the respondent, may be regarded as one and the same entity. See the cases cited in *In re Ludwig Casca*, 34 Agriculture Decisions 1917, 1930-1933 (1975).

$48,619.58 more than reasonable expenses and depreciation. This, for a part-time activity[31] and a relatively modest investment!

Of the $48,619.58, $6,515.73 was allowed as a reasonable return on respondent's land, buildings and equipment, and working capital, *i.e.*, the elements that would comprise respondent's rate base under traditional public utility ratemaking principles. The allowances totalling $6,515.73 for respondent's land, buildings and equipment, and working capital appear adequate. The actual rate of return on these "rate base" elements is 11.2%.[32]

However, assuming for the purposes of argument that the allowances on the elements comprising respondent's "rate base," totalling $6,515.73, are too low, before we could conclude that complainant's rates were unreasonably low or confiscatory, we would have to determine that Giles Lowery's total stockyards income, after reasonable expenses, depreciation and taxes, is unreasonably low, considering his prudent investment and his personal services. If more than $6,515.73 were required to preclude confiscation, more than enough could be "transferred" to

31. Giles Lowery operates two stockyards, engages in an extensive dealer business and has other business activities (Tr. 208, 218).

32. Respondent's rate base under accepted public utility principles would be $58,286.62, consisting of (1) $13,325 for value of used and useful land, assuming respondent's land valuation is correct (Finding 21, *supra*); (2) $32,618.99 for value of buildings and equipment (Finding 20, *supra*); and (3) $12,342.63 for working capital (see complainant's Reply Brief, p. 15). Dividing $6,515.73 by $58,286.62 equals 11.2%. In the case of the owners of all public utilities, they receive a return on the total value of their rate base, but to the extent that their rate base resulted from borrowed money, their actual net income is, of course, reduced by the amount of interest they have to pay on such borrowed money. In this case, Giles Lowery borrowed money at 8%, and he is making a return of 11.2% on his "rate base," in addition to receiving $42,103.85 ($48,619.58 – $6,515.73) not based on his "rate base."

the $6,515.73 from the allowances made for Giles Lowery's personal services and operating margin.

As shown above in the subsection relating to owner's compensation, the allowance of $15,839.40 to respondent for Giles Lowery's efforts as a working owner (which is in addition to the allowance for his "management") is substantially more than the $5,000 per year received by other persons who perform functions similar to Mr. Lowery's primary function at the stockyards.

Moreover, complainant's rate formula provides an "operating margin" of $22,715.20 over and above all reasonable expenses and depreciation. This is a "cushion for unexpected contingencies," so that the market does not have to "come in every year * * * for another rate increase" (Tr. 40). If need be, part of this "cushion" could be "transferred" to the allowances for land, buildings and equipment, and working capital.[33]

Considering all of the circumstances in this case, if complainant has erred, the error has been on the side of proposing a rate schedule that is too high (see Tr. 172, 186-187). There is no basis whatever for a determination that the end result, *viz.*, rates that will produce $184,824.58 are unreasonably low or confiscatory.

For the reasons set forth above, respondent's rates are unjust and unreasonable. Complainant's proposed rates

33. Assuming (as we must based on this record) that complainant's forecast is accurate with respect to the temporary nature of the decline in livestock volume in fiscal 1974, no substantial part of the operating margin would be needed for any extended period to compensate for reduced volume. Also, most auction stockyards do not pay separate income taxes (Tr. 171), but respondent corporation does pay separate income taxes (Tr. 85-86, 149). Hence part of the operating margin would be used for corporate taxes, but a substantial portion would be left for other purposes.

are just, reasonable and non-discriminatory, and should be adopted.

ORDER

The respondent shall assess the schedule of rates and charges as set forth below, and shall not, hereafter, publish, demand, or collect any rate or charge for the furnishing of any stockyard service more or less than the rate or charge for the services set forth in such schedule:

A. *REGULAR SELLING-YARDAGE CHARGES*

Ordinary Cattle:

Weighing less than 300 lbs.	$ 3.00 Per Head
Weighing 300 lbs. and more	3.50 Per Head

Bulls:

All bulls 800 lbs. and over	10.00 Per Head
Cows and Calves sold as pairs	5.40 Per Pair
Horses, Ponies, and Mules	6.00 Per Head

Hogs:

Sows, Boars, Shoats and Feeders	1.00 Per Head
Sow and pigs sold as a unit	2.00 Per Unit
Sheep and Goats	1.00 Per Head

B. *RESALE AND NO SALE CHARGES*:

Definitions: (1) Resale charges shall apply on all livestock resold without leaving the market premises.

(2) No-sale charges shall apply when a consignor declares his consignment no-sale on price bid, bids in his consignment, or withdraws the same prior to actual sale.

Charges: One-half (½) of the regular selling and yardage charges shall be assessed on all resales and no-sales.

C. *FEED*:

The charge for all feed sold shall be the average monthly cost F.O.B. the market plus $0.005 per lb., $0.50 per cwt.

D. *VETERINARY SERVICES*:

The schedule of charges on all necessary veterinary services performed by an accredited veterinarian will be at posted uniform per head rates, pursuant to company agreement with the veterinarian performing such services and does not contain any charges retained by the market.

E. *SPECIAL SALES OR SERVICES*:

Special sales or unusual stockyard services such as are included in featured registered cattle and calf sales, annual 4-H sales, and sales for one consignor sold on other than regular sale days which require special services and handling will be charged for under special arrangements agreed to between the parties prior to the special sales.

This Order shall become effective 30 days after service thereof upon the respondent.

APPENDIX C

UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

In re:	)	
Giles Lowery Stockyards, Inc., d/b/a	)	P&S Docket
Lufkin Livestock Exchange,	)	No. 4782
Respondent	)	

DECISION AND PROPOSED ORDER

Preliminary Statement

This is a proceeding under Title III of the Packers and Stockyards Act, 1921, as amended (7 U.S.C. 181 *et seq.*), hereinafter referred to as the Act, involving the rates and charges assessed by the Respondent corporation for rendering auction market services at the Lufkin Livestock Exchange, Lufkin, Texas.

On March 28, 1973, Respondent filed with Complainant a new tariff (Tariff No. IV), which assessed greater rates and charges for auction market services than the tariff (Tariff No. III) then on file and in effect. Tariff No. III, which had been in effect since September 4, 1972, was accepted for filing by Complainant on the basis of financial information contained in Respondent's annual report to Complainant for the fiscal year ending June 30, 1972. Upon filing Tariff IV Respondent furnished no additional information (except that which was previously available for the period ending June 30, 1972) in support of the increase in the rates and charges. Thereafter Complainant concluded that a further rate increase would be unreasonable, and by Complaint, Order of Suspension and Notice of Hearing, filed herein on April 13, 1973, rejected Tariff IV. Accordingly, the operation of Tariff IV, which was to go into effect on April 6, 1973, was suspended, as authorized by the Act, for a period of 30 days. The Complaint, Notice of Hearing and Order of Suspension was published in the

Federal Register on May 9, 1973 (38 F.R. 12143) and among other things stated that "respondent and all other interested parties will have a right to appear" and present relevant evidence. The suspension was subsequently extended for an additional 30 days followed by publication in the Federal Register on May 23, 1973 (38 F.R. 13590).

Thereafter, the matter was referred to me and an oral hearing for the receipt of evidence was conducted on June 25 and 26, 1974, in Lufkin, Texas. Robert Flournoy, Esquire, of Lufkin, Texas, represented Respondent, and Thomas C. Heinz, Esquire, Office of the General Counsel, United States Department of Agriculture, represented the Complainant.

The parties filed Stipulation 1 with the Hearing Clerk on June 14, 1974. Stipulation 2 became a part of the record during the hearing, and Stipulation 3 was filed after the hearing on August 9, 1974.

Findings and Conclusions

The following findings and conclusions are based on the record evidence herein which includes the transcript of hearing, exhibits, material submitted via Stipulation 3, and matters officially noticed as per request of the parties. To avoid undue repetition and to facilitate the discussion of the reasons and bases for our findings of fact and conclusions, we have made no attempt to set forth such findings separately from the conclusions pertaining thereto. For convenient reference, we have included as Figure 1 a resume of the findings and conclusions herein. It represents a cost and revenue analysis of Respondent's auction market activities during the base period, July 1, 1972 through June 30, 1973. Frequent reference will be made in the findings and conclusions to the line entries appearing in Figure 1. In arriving at findings and conclusions herein, all contentions of the parties have been considered, whether or not specifically mentioned.

LUFKIN LIVESTOCK EXCHANGE
LUFKIN, TEXAS

COST AND REVENUE ANALYSIS FOR RATE PURPOSES
AFTER AUDIT

(BASE PERIOD 7/1/72—6/30/73)

			Adjustments (Removals)		
1.		Expenses per Rate Audit			203,846.57
2.	*LESS*:	Compensation to Owner			
3.		Salary	14,070.00		
4.		Solicitor's Fee	6,307.29		
5.		Total Compensation		20,377.29	
6.	*LESS*:	Interest paid	14,537.05		
7.		Bad debts	4,410.23		
8.		Pasture rent	300.00		
9.		Trucking & Hauling	9,370.78		
10.		Church contributions	70.00		
11.		Donations	461.00		
12.		Non-Auction Market Expenses	1,318.75		
13.		Total		30,467.81	
14.					
15.	*LESS*:	Business Getting & Maintaining Expenses			
16.		Advertising	2,497.34		
17.		Solicitor's Expense	500.00		
18.		Market Support—Per Books	24,239.76		
19.		Market Support—Confirmed [4,063.59]			
20.		Market Support—Unconfirmed [20,176.17]			
21.		Total		27,237.10	
22.		Adjusted Expenses ($203,846.57 less L 5, 13, 21)			125,764.37

			Adjustments (Additions)		
22.		Adjusted Expenses			125,764.37
23.	*PLUS*:	Compensation for Working Owners	15,839.40		
24.		Allowance for Owner's Management and Interest on Working Capital	4,259.10		
25.		Total allowance for Owner's Efforts		20,098.50	
26.	*PLUS*:	Allowance for Business Getting and Maintaining (L 16+17+19)	7,060.93		
27.		Allowance for return on building and equipment	2,398.60		
28.		Allowance for use of land	3,407.28		
29.		Allowance for additional depreciation	609.81		
30.		Allowance for Bad Debts	2,769.89		
31.				16,246.51	
32.		(L 22+25+31)			162,109.38
33.	*PLUS*:	Allowance For Operating Margin	22,715.20		
34.		Total Reasonable Revenue Requirements			184,824.58
35.		Total Revenue (Selling Commissions & Yardage) Per Audit			214,175.41
36.		Current Revenue in excess of requirement (L 35 – L 34)			29,350.83

Figure — 1

1. Giles Lowery Stockyards, Inc., d/b/a Lufkin Livestock Exchange, hereafter called Respondent, is a corporation with a place of business at Lufkin, Texas.

2. Respondent is, and at all times material herein was:

(a) engaged in the business of conducting the Lufkin Livestock Exchange, a posted stockyard under the Act;

(b) engaged in the business of selling livestock on a commission basis at the stockyard; and

(c) registered with the Secretary of Agriculture as a market agency to sell livestock in commerce.

3. Giles Lowery Stockyards, Inc. is composed of two divisions, the Lufkin Livestock Exchange and the Bay City Livestock Commission. The Lufkin Livestock Exchange was posted in March 1959 and was incorporated in February 1960. According to the annual report for 1966, Herbert Lowery then owned 98 percent of the shares of stock in the corporation while Giles Lowery owned 1 percent. In November 1968 Giles Lowery purchased the Lufkin Livestock Exchange from Herbert Lowery. In December 1968 the Giles Lowery Stockyards, Inc., became a separate corporation in which Giles Lowery owned 100 percent of the stock. (Tr. 7-9)

4. Complainant having approved Respondent's Tariff III in September 1972, based upon Respondent's annual report for fiscal year ending June 30, 1972, thereafter concluded that Respondent's proposed Tariff IV, which assessed increased rates and charges for its auction market services and which was based on the earlier June 30, 1972 annual report, was unreasonable and suspended the operation of said tariff for a period of 60 days. (Stipulation 1, Tr. 6-7, 75-78, 144-145, 151-152)

5. Section 304 of the Act (7 U.S.C. 205) imposes the duty on every stockyard owner to furnish upon request,

without discrimination, reasonable stockyard services at such stockyard. Section 305 (7 U.S.C. 206) provides that all rates or charges made for any stockyard services furnished at a stockyard by a stockyard owner shall be just, reasonable, and nondiscriminatory. Any unjust, unreasonable, or discriminatory rate or charge is prohibited and declared to be unlawful. Whenever after full hearing the Secretary is of the opinion that any rate or charge of a stockyard owner, for or in connection with the furnishing of stockyard services, is or will be unjust, unreasonable, or discriminatory, the Secretary may determine and prescribe what will be the just and reasonable rates or charges to be thereafter in such case observed as both the maximum and minimum to be charged (7 U.S.C. 211). *In re St. Paul Union Stockyards Co.*, 21 A.D. 1216, 1223 and 1241 (1962).

6. Previous decisions hold that only those operating expenses determined to be reasonable are to be included in the determination of reasonable rates and charges. *St. Joseph Stock Yards Co.* v. *U.S.*, 298 U.S. 38, 53 (1936); *Denver Union Stockyard Co.* v. *U.S.*, 304 U.S. 470, 475 (1938); *Secretary of Agriculture* v. *H. L. Bowman, d/b/a H. L. Bowman Cattle Co.*, 1 A.D. 425, 429-430 (1942); *In re St. Louis National Stockyards Co.*, 2 A.D. 664, 671-672 (1943); *In re Denver Union Stockyard Co.*, 10 A.D. 1033, 1060-1061 (1951). For the stockyard services rendered by the Respondent, it is entitled to assess a schedule of rates and charges to be paid by the consignor of livestock at the auction barn, which will produce gross revenues sufficient to pay all reasonable operating expenses plus a fair return on the net value of the property it has devoted to the rendition of such services.

7. In connection with Respondent's proposed Tariff IV, Complainant conducted an audit of Respondent's books and records for the period July 1, 1972 through June 30,

1973 hereafter called the "base period" (Tr. 6-7), and applied to the results of such audit a revenue analysis method designed to determine the reasonable revenue requirements. That analysis begins with the total expenses incurred during a twelve-month base period and removes certain expenses which have been determined to be unreasonable. To the resulting figure are added certain expense allowances which are considered reasonable. The final figure is the reasonable revenue requirement. The same analytical method is used to examine every auction market requesting a tariff increase, and it was this method that was used here (Tr. 10-11, 145-146, Cx-1).

Respondent contends that the period 1973-1974 should be used, rather than 1972-1973, as the base period for examination in this proceeding. However it would have been impossible to complete an audit of Respondent's 1973-1974 year's operation in time for the oral hearing since Respondent's fiscal year closed after the hearing. Annualized figures could have been used, but because such figures result from averaging, they are unreliable.

As stated by Witness Brinckmeyer, "You have to establish a test period and move from there. If you try to continue to try to update it you would never reach a point where you could make a determination of what the reasonable costs were." (Tr. 235)

In *In re St. Paul Union Stockyards Company*, 21 A.D. 1216, a "cut-off" date of October 31, 1957, was established because it was found "impracticable to keep revising the evidence adduced so as to have it current as of the conclusion of the proceeding." (21 A.D. 1216 at 1225) The case was decided on November 7, 1962. In *Railroad Commission* v. *Houston Natural Gas Corporation*, decided May 9, 1956, the rate base was determined as of December 31, 1952. (289 S.W. 2d 559 at 574)

Accordingly, we find no infirmity in the use of the 1972-1973 period as the based period.

8. Upon completion of the financial audit of Respondent's books and records, it was determined that the total expenses incurred by Respondent in the rendition of auction market services during the base period were $203,846.57 (Fig. 1, L 2—Tr. 12)

9. During the base period Respondent paid to Mr. Giles Lowery, who owns 100 percent of the corporate stock of the Respondent, $20,377.29, consisting of $14,070 in salary and $6,307.29 as solicitor's fee (Fig. 1, L3, 4, 5).

In accordance with the analytical method described in No. 7, *supra*, several categories of expense were deducted from the total expense figures, beginning with the compensation of $20,377.29 paid by Respondent to its working owner. The amount of compensation paid to a working owner by a corporation, entirely owned by that owner, is not an amount arrived at through arms-length bargaining. Such amount is, therefore, removed from expenses and replaced with an allowance deemed reasonable as discussed in No. 13, *infra* (Tr. 13-14, 79-88).

10. During the base period Respondent:

(a) paid $14,537.05 in interest on outstanding debts (Fig. 1, L 6);

(b) incurred bad debt losses of $4,410.23 (Fig. 1, L 7);

(c) paid $300 for rent on a pasture ten miles distance from the auction market (Fig. 1, L 8);

(d) expended $9,370.78 for trucking and hauling services (Fig. 1, L 9);

(e) made contributions to churches of $70.00 and donations to other organizations and individuals of $461.00 (Fig. 1, L 10, 11); and

(f) Incurred expenses of $1,318.75 (Fig. 1, L 12).

The record discloses that the interest in the amount of $14,537.05 was paid on an S.B.A. loan to liquidate debts and not for capital improvements. This type of expense should not be borne by the consignors of livestock, the ratepayer, but by the corporation's shareholders.

Further, if the interest was not removed the ratepayer would be paying twice for the borrowed funds, once in the form of interest and once in the form of depreciation expense allowed on depreciable assets purchased with the borrowed funds (Fig. 1, L 27, 28, 29—Tr. 14, 88-91).

Interest costs should be borne by the stockholder and not by the ratepayer. See: *Denver Union Stock Yard Co.* v. *U.S.*, 304 U.S. 470, 482-483 (1938).

Since a stockyard operator is required by the Act and the regulations (7 U.S.C. 208, 213; 9 CFR 201.43) to pay consignors when their livestock is sold, whether or not the purchasers pay, stockyards may, and generally do, incur some bad debt expense. However, in some cases, an extraordinarily large bad debt expense for a particular year has been the sole basis for a request to increase rates (Tr. 14, 93-94, 169). For this reason, actual bad debt expenses are removed and replaced with an allowance (Fig. 1, L 30) as discussed in No. 18, *infra.*

A $300-pasture rent expense was deducted because the pasture, approximately ten miles distance from the Respondent's market, was not used or useful for auction market purposes (Cx-1; Tr. 15, 95).

Trucking and hauling expenses of $9,370.78 were deducted from the allowed expenses because the Respondent's records were inadequate and did not indicate that consignors of the market had benefited from these expenses (Tr. 15-17, 95-105; Cx-1, 2).

Church contributions of $70.00 and donations of $461.00 were deducted because it is not considered reasonable that ratepayers make involuntary donations to charities not of their choice. The interests and purposes of the recipient charitable organizations may in fact be totally opposed to the interests and purposes of some consignors. Such donations are therefore consistently disallowed in revenue analyses of stockyards and auction markets (Tr. 17-18, 105-106). See *St. Joseph Stock Yards Co.* v. *United States et al.*, 11 F.Supp. 322, 329.

Non-auction market expenses of $1,318.75 incurred during the base period were deducted. These expenses which were entered on Respondent's books and records were expenses which should not be borne by ratepayers.

Of the $1,318.75 total, $167.82 was the proportionate share of a bond premium covering the Bay City operation (Tr. 18-19, 107; Cx-3).

Complainant also removed a depreciation expense and a utility expense of $531.99 associated with a house adjacent to the auction market which is occupied by an employee of the market and his family. That employee also receives a substantial salary of approximately $250 per week. Thus, it is inappropriate for ratepayers to be asked to support an auction market employee's family beyond the amount of the salary paid that employee. There is no evidence showing the employee's family has rendered any service or benefit to consignors of the market (Tr. 19, 107-111, Cx-3).

Franchise taxes of $93.94 applicable to Bay City Livestock Exchange, but paid by the Lufkin Exchange, were removed as not applicable to Respondent market (Tr. 19, 111; Cx-3).

Legal fees of $25 and accounting fees of $500 were removed since they were for services received in the year preceding the base period. Respondent's accounts are kept on an accrual basis, i.e., expenses are to be entered on the books when accrued and not when paid (Tr. 19, 111-112, 354; Cx-3).

11. During the base period Respondent:

(a) expended $2,497.34 for advertising designed to promote the interest of consignors (Fig. 1, L 16);

(b) expended $500 for "solicitor's expense" (Fig. 1, L 17); and

(c) incurred, according to Respondent's books and records, expenses of $24,239.76 which were entered in an account labelled by Respondent "market support" (Fig. 1, L 18).

Of this amount only $4,063.59 could be verified and confirmed (Fig. 1, L 19).

At this point in the revenue analysis, all business getting and maintaining expenses are removed, and some are added back at a later stage. These expenses are of the type incurred by an auction market to persuade consignors to patronize the market, such as advertising and market support. Respondent's advertising costs were $2,497.34 during the base period. This amount excludes $25 for Kiwanis Breakfast Club and $72 for box seats paid to the Lions Club Rodeo Association, which amounts appeared in Respondent's records in the advertising account before removal by Complainant. Complainant's auditor correctly

considered these two items more appropriately expenses of Mr. Giles Lowery personally than items chargeable to the market's advertising account. There is no evidence to show these items did in fact constitute market advertising (Tr. 20-22, 112-114; Cx-4).

A solicitor's expense of $500 was removed as a business-getting expense (Tr. 22-23, 114-115).

One of the central issues in this proceeding is the question of market support. Respondent takes issue with Complainant's accounting procedures and maintains that the auction barn derives no revenue from the purchase of livestock under the market support program. For accounting purposes Respondent argues that lines 1 and 18 (Fig. 1) are overstated by $16,648.63. Respondent would reduce the expenses, line 1, from $203,846.57 to $187,197.94 as well as line 18 from $24,239.76 to $7,591.13. The total revenue, line 35, likewise would be reduced to $197,526.78, thus reducing the excess current revenue, line 36, from $29,350.83 to $9,857.55 (Tr. 317-328, Rx-3).

For rate regulation purposes, it makes little difference whether Complainant's accounting treatment of market support is followed or whether Respondent's approach is followed. In the final analysis, the net result is the same: the expenses and losses associated with the sale of animals purchased in support of the market are balanced against income derived from the sale of such animals.

Market support does not constitute a guarantee to the consignor by the market operator that consigned cattle will sell at or above a specified price. Section 201.64 (9 CFR 201.64) of the regulations promulgated under the Act expressly prohibits this practice: "No market agency or licensee engaged in the business of selling livestock or live poultry on a commission basis shall guaranty the price at which consigned livestock or live poultry will be sold."

Market support is the term generally used in the auction market business to describe the bidding by a market operator or his representative at auction which bidding ends in the purchase of the animal by the market. Such bids are placed not with the intention to purchase the animal, but rather to stimulate bids from other buyers. It is important to note that this process is entirely voluntary; many markets do not engage in it.

Animals purchased through market support are either again run through the auction ring at the same market or transported to another market for sale. The market support account at a market is charged with the losses, if any, associated with disposing of such animals. Where applicable, these losses include transportation costs, feed costs and the difference between the purchase price at which the market bought the animal and the selling price of the animal when the market sold it.

From an accounting standpoint, the transactions are treated thusly: upon purchase by the market, the commission revenue account is credited with the amount of commission paid by the consignor for the sale of his animal; the custodial account for shippers' proceeds is credited with the net proceeds of the sale, and the market's livestock inventory account is debited for the gross sales amount. Upon resale, the sales proceeds are debited to the cash account; the livestock inventory account is credited for the gross sale amount (the amount debited above) and whatever losses, if any, associated with the resale of the animal are charged to the market support account.

According to its books and records Respondent incurred expenses of $24,239.76 for market support during the base period. Of that amount $4,063.59 could be verified and confirmed. By "confirmed" expenses is meant those expenses resulting from the purchase by Respondent at

Respondent's market of specific, identifiable cattle consigned to the market, plus expenses flowing from the sale by Respondent of such cattle to named, identifiable, third-party purchasers. In other words, in order to confirm a market support expense, it is necessary to trace the animals head-by-head from consignors to ultimate purchasers (Tr. 23-29, 117-127, 134-142, 147-149, 334; Cx-1, 5).

We conclude that Complainant's treatment of this account is consistent with Section 401 of the Act which states in part: "Every . . . stockyard owner, market agency, and dealer shall keep such accounts, records, and memoranda as fully and correctly disclose all transactions involved in his business . . ." (7 U.S.C. 221)

12. Respondent's reasonable general operating expenses during the base period were $125,764.37 (Fig. 1, L 22).

13. During the base period, Respondent sold 56,788 marketing units of which 56,292 were cattle. One marketing unit, or livestock unit, is one cattle, or three hogs, or four sheep, or four goats or one horse or one mule.

Accordingly, it was reasonable for Respondent selling 56,788 marketing units during the base period:

(a) to compensate its owner who functioned primarily as the "starter" at the auction market in an amount no greater than $15,839.40 (Fig. 1, L 23); and

(b) to compensate its owner during the base period for management services and invested working capital in an amount no greater than $4,259.10 (Fig. 1, L 24).

When the total actual business getting and maintaining expenses are removed along with the other deductions, Respondent's adjusted expenses for the base period come

to $125,764.37. To this amount is added a series of allowances beginning with an allowance for compensation to a working owner.

Mr. Giles Lowery was a working owner of Respondent, in that he was actively involved in the operation of the market. His primary function at the weekly auction was to serve as "starter" (Tr. 160; Stipulation 3, Cx-II). A "starter" sets the starting price or opening bid of consigned cattle when such cattle are placed in the auction ring and put up for sale.

The allowance made for Respondent's working owner was $15,839.50. This figure was derived using the compensation formula described in Complainant's Exhibit Cx-6.[1] An important part of the formula is the concept of an animal or marketing unit. This concept was devised because the costs associated with the sale of different species varies according to the species. Yet revenue anal-

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1. Compensation for one working owner is based on the following formula:

	No. of Head				Animal Units
Cattle	56,292	x	1	=	56,292
Calves	–0–	x	1	=	–0–
Hogs	827	x	⅓	=	276
Sheep	–0–	x	¼	=	–0–
Horses	220	x	1	=	220
			Total animal units		56,788

Animal Units		
Up to 20,000 units	20,000 x $ 0.50 =	$10,000.00
Next 20,000 units	20,000 x $ 0.25 =	5,000.00
All over 40,000 units	16,788 x $ 0.05 =	839.40
		$15,839.40

The allowance for management and interest on working capital is computed as follows:

Animal units 56,788 x $0.075 = $4,259.10

ysis requires consistent treatment of all livestock sold at market. Therefore, Complainant developed this conversion formula: one cattle equals three hogs equals four sheep equals four goats equals one horse equals one mule. This formula was supported by a statistical analyses by Mr. Everett Stoddard, an Agricultural Economist for Complainant and is confirmed in a study conducted by Texas A & M University as contained in a report, *Factors Affecting Auction Market Operating Costs*, published in 1966.

The compensation formula provides 50 cents per unit on the first 20,000 units sold at the market, 25 cents per unit on the next 20,000 and 5 cents per unit for each unit over 40,000.

The 20,000 break derives from *In re Market Agencies at the Sioux City Stock Yards*, 9 A.D. at 92, where it was found that 20,000 units is a reasonable yearly sales volume for one cattle salesman, though some salesmen can sell twice that number. Of course, there are no cattle salesmen at an auction market, but Complainant analogizes one cattle salesman to one working owner.

The 40,000 break is based on the concept that above this point additional people probably will have to be hired to accomplish the task. See Texas A & M study referred to above, page 20.

The 5 cents per unit compensation on sales above 40,000 per year is designed to give the working owner some incentive to increase his volume.

The *Sioux City* case holds that the allowance for a working owner should be no greater than the going rate for the work that owner actually performs; that is, the allowance should equal the amount for which the market could hire a third party to perform the job. We have already seen that Respondent's working owner serves as

the starter at the weekly auction. The record evidence shows starters generally receive $100 per sale or less, and information taken from the annual reports filed by auction market operators with Complainant confirms this fact. An index of the reasonableness of the $15,839.40 allowance is the fact that Respondent during the base period paid a full-time employee $13,000.

Added to the compensation for a working owner is an allowance for owner's management and interest on working capital. Respondent's allowance is $4,259.10, consisting of 6.25 cents per animal unit for management and 1.25 cents per animal unit for working capital.

The 6.25 cents figure derives from the *Sioux City* case (9 A.D. 4, 99) where such amount was deemed reasonable. In 1970 in order to see if the allowance was still reasonable, Complainant surveyed markets having pure management costs, that is, markets having managers performing no other function. That survey indicated that management costs averaged 5.3 cents per animal unit sold. In other words, the survey indicated 6.25 cents per unit is generous.

The 1.25 cents per unit allowance for working capital also derives from the *Sioux City* case (9 A.D. 97).

These amounts are allowed whether or not the owner is actively engaged in the operation of the market on sale days. (Tr. 30-33, 160-163, 207-218, 273-287; Cx-6, 12; Stip. 3—Cx-I, II, III, IV, IX)

14. Respondent is provided an allowance of $7,069.93 for business getting and maintaining expenses, which constitutes the actual, confirmed expenses during the base period. (Fig. 1, L 26)

The allowance is based on 25 cents per animal unit *or* actual expenses, whichever is less.

Witness Brinckmeyer described such expenses to include "advertising, solicitor's costs, market support expenses, travel and entertainment, and expenses like this that the market puts out to get consignors to the stockyard." (Tr. 165)

The Secretary of Agriculture had earlier concluded that there must be a limit on the amount ratepayers pay to convince themselves to patronize a stockyard or auction market. That limit was set at one-ninth of the gross commission earned or 10 percent of the gross commissions minus business getting and maintaining expenses. See *In re H. L. Bowman, d/b/a H. L. Bowman Cattle Company*, 1 A.D. 425, 431. The 10-percent formula was replaced in the *Sioux City* case by a per-head allowance for each species sold at the stockyard. The allowances were: 10 cents per head for cattle and calves, 4 cents per head for hogs and 2 cents per head for sheep.

In recognition of the inflation which has occurred since the *Sioux City* case, the formula has been increased to 25 cents per animal unit. Complainant has tested the reasonableness of its formula using the one-ninth (11.11 percent) measure from previous rate cases. Witness Stoddard compared the old and new methods of determining allowable business getting and maintaining expenses. Using a statistical sample of 244 auction markets taken from the 1972 reporting year, Mr. Stoddard found that the old method would have produced an allowance of 24.45 cents per marketing or animal unit. Under the new method, the result was 22.2 cents per marketing unit. (Tr. 275-277; Cx-12) The difference of 2.25 cents per unit is compensated by the application of Complainant's new method of determining allowances for operating margin. See No. 19, *infra*.

Accordingly, we conclude that it was reasonable for Respondent to be allowed for business getting and maintaining expenses, no more than 25 cents per marketing unit *or* the actual, confirmed business getting and maintaining expenses, whichever was less. (Tr. 33, 163-165, 275-277; Cx-12)

15. Respondent's allowance for return on building and equipment is $2,398.60, which is 8 percent of $29,982.46. (Fig. 1, L 27)

The book value of buildings and equipment of $27,130.67 as shown in Exhibits Cx-1 and 7 should be increased by the net value of unloading docks constructed during the base period at a cost of $6,098.13. Deducting depreciation on the docks of $609.81 (and its entry on line 29, Fig. 1) leaves a book value of $32,618.99. However, an additional adjustment must be made for the rental house which has a book value of $2,636.53.[2] Since the house is not used and useful for auction market purposes, its book value must be deducted for revenue analysis purposes, leaving $29,982.46 as the final net book value of Respondent's buildings and equipment used and useful for auction market purposes. (Tr. 34-37, 165-167; Cx-1, 3, 7)

Records filed with Complainant reveal (Cx-7) that as of December 13, 1967, the undepreciated book value of the Lufkin Livestock Exchange facility was $76,817.18. Accumulated depreciation of $51,383.55 left the net book value of the buildings and equipment of $25,433.63 as of

2. Although unable to locate a precise reference to the $2,636.53 in the record it can be computed in this manner:

$$\frac{\text{1973 Book Value all bldgs. (Cx-7)}}{\text{1973 Depreciation all bldgs. (Cx-7)}} \times \text{Depreciation for rental home (Cx3)} \quad \text{or} \quad \frac{\$12,465.90 \times \$292.95}{\$1,385.10}$$

this date. In December of 1968 Mr. Giles Lowery purchased the facility from its original owner, and the operation changed from a calendar year basis to a fiscal year basis ending on June 30 of each year. It was, therefore, necessary to estimate the net book value of the assets as of December 31, 1968, a year for which no annual report for Lufkin Livestock Exchange was submitted to Complainant. Since more than $5,000 in depreciation had been taken in 1967, a similar amount would reasonably have been taken in 1968 had the facility remained in the hands of the original owner. For this reason, Witness Hammond set the net book value of Respondent's buildings and equipment at $20,000 as of December 31, 1968. Capitalized improvements and annual depreciation from that date leave the net depreciated book value of Respondent's buildings and equipment at $29,982.46 as of June 30, 1973, the close of the base period.

Valuing Respondent's buildings and equipment at original cost minus depreciation, conforms to the rationale in *In re St. Paul Union Stockyards Company*, 21 A.D. 1216. In that case the Judicial Officer adopted the original cost method of valuation, and at page 1266 quoted Mr. Justice Brandeis in his dissenting opinion in *Southwestern Bell Telephone Company* v. *Public Service Commission of Missouri* (262 U.S. 276, 290): "The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return. . . ."

The Judicial Officer stated further: "Moreover, an original cost rate base is determined from the facts and not theories, estimates and speculations and the fixing of such a rate base at any time simply involves the adding

of capital expenditures and deducting retirements and depreciation as shown by accounting records subsequent to any previous date when the rate base was fixed. The original cost method avoids expensive appraisals and the controversies incident thereto."

Respondent takes the position that Complainant has not accurately determined a fair value rate base and urges adoption of a formula for determining rate base found in *Railroad Commission of Texas* v. *Houston Natural Gas Corp.*, 289 S.W. 2d 559, wherein the Texas Supreme Court endorsed a "reasonable balance" between original cost less depreciation and replacement cost new less deterioration and obsolescence.

Complainant's position is that the reproduction cost new less depreciation method of valuation of buildings and improvements and movables is speculative, unreliable, and has no real relationship to the actual experience of stockyards. It argues that the most reliable, most stable, and most equitable basis for the valuation of such property is the original cost or invested capital cost of the property.

In *Federal Power Commission* v. *Natural Gas Pipeline Company*, 315 U.S. 575 (1942), the United States Supreme Court sustained an order of the Commission under the Natural Gas Act. In discussing the scope of judicial review of rates prescribed by the Commission, the Court held that (315 U.S. at 586):

> The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.

In *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944), the Supreme Court again considered an order of the Federal Power Commission prescribing rates under the Natural Gas Act. The Commission established the rate base on the basis of the "actual legitimate cost" of the property involved less depreciation (320 U.S. at 596). Evidence of the cost of reproduction new was rejected on the grounds that it was "not predicated upon facts" and was "too conjectural and illusory to be given any weight" (320 U.S. at 597). The Commission also refused to give any "probative value" to "trended original cost" because it was "not founded in fact," was "basically erroneous," and produced "irrational results" (320 U.S. at 597).

Previously, the Court of Appeals for the Fourth Circuit (134 F.2d 287) reversed the Commission's order, and among the grounds for reversal were: (1) that the rate base should reflect the "present fair value" of the property; (2) that the Commission should have considered reproduction cost and trended original cost; and (3) that "actual legitimate cost" was not the proper measure of "fair value" where price levels had changed since the investment.

The Supreme Court reversed the Court of Appeals and stated that (320 U.S. at 602):

> We held in *Federal Power Commission* v. *Natural Gas Pipeline Co., supra,* that the Commission was not bound to the use of any single formula or combination of formulas in determining rates. Its rate-making function, moreover, involves the making of "pragmatic adjustments." And when the Commission's order is challenged in the courts, the question is whether that "viewed in its entirety" meets the requirements of the Act. Under the statutory standard of "just and rea-

sonable" it is the result reached not the method employed which is controlling. . . . It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.

To determine what a reasonable rate of return is for auction markets is extremely difficult. Complainant's most recent guide is the *St. Paul* case, decided in 1962. The Judicial Officer stated in that case (21 A.D. 1216 at 1291):

> We believe we shall discharge our obligations to the investor and treat the rate payer fairly if we provide revenues sufficient for the company to pay (a) its actual operating expenses prudently and ecnomically incurred; (b) an annual charge for depreciation based upon the expected life of the properties; (c) taxes; (d) interest on its debt at the rate actually paid; (e) a reasonable dividend on its outstanding stock; and (f) something to be added to the surplus to enable the company, under good management, to maintain and support its credit.

Elements (a) and (b) have already been discussed. As for (d), the Respondent corporation borrowed funds from the Small Business Administration at 8 percent annual interest. Some $23,000 of the borrowed funds were received by the corporation (Tr. 89-90). An 8-percent rate of return therefore allows Respondent to service its debt.

Concerning (e), there are presently no stockyards in the industry having stock traded openly. Therefore, there are no price-earnings ratios or other tests to determine what stockholders are willing to pay or require as a fair

return on equity capital to get into the stockyard business (Tr. 166-167).

Since the stockyard industry provides no reliable guide for rate of return, Complainant cites other regulated industries, particularly the public power utilities, for guidance on the question. Recent cases show wide variations in rate of return. The majority, however, are in the range of 8 percent. The following table of cases is representative.

Company				
Utilities & Industries Corp.	100 PUR 3d	467, 474	7.57	8- 9-73
South Central Bell Tele. Co.	100 PUR 3d	502, 504	6.93	8-21-73
Union Light, Heat & Power Co.	100 PUR 3d	518, 522	8.67	8-13-73
Pacific Northwest Bell Tel. Co.	100 PUR	82, 103	8.93	7-14-73
Capital City Water Co.	100 PUR 3d	124, 126	7.76	6- 1-73
Kansas-Nebraska Natural Gas Co., Inc.	100 PUR 3d	129, 138	8.5	7-26-73
New England Tel. & Tel. Co.	100 PUR 3d	189, 199	8.93	6-25-73

Respondent urges by way of its proposed Finding of Fact No. 14: "A small stockyard like this company has a greater risk and needs a greater return than other utilities." No evidence was introduced to show an actual greater risk in the stockyard industry. In fact, Witness Brinckmeyer testified that from January 1972 to May 1974 there was only a net change of 5 in the total number of

posted stockyards, that is, there were five fewer stockyards in May 1974 than in January 1972. (Tr. 199-200) There are approximately two thousand stockyards in the United States. (Tr. 174)

Respondent urges that a rate of return for a regulated utility should be sufficient to "attract" capital. The point is made by evidence going to the current condition of the money market. (Rx-7, 8, 9, 10, 11, 12) However, Respondent does not have stock traded openly.

Accordingly, we conclude that an 8-percent rate of return on the net book value of buildings and equipment is reasonable.

16. The reasonable allowance to Respondent for use of land during the base period was $3,407.28. (Fig. 1, L 28)

The $3,407.28 is derived by using a formula of 6 cents per animal unit times the number of animal units sold during the base period (56,788). The basis for the formula was explained by Witness Brinckmeyer at Tr. 167-168:

> [W]hen I started handling the rate work for our agency we were exploring several methods of determining the value of land, what we should use. If we went back to the original cost as the Hope Natural case said we could, it would have had a very startling effect on the industry.
>
> So after trying to index it on farm prices of land and several other things, we determined that some allowance for the use of land based on the unit of livestock would probably be the most fair way to the regulated industry and to the ratepayer and treat each one of them fairly.
>
> In the early 1960's appraisals had been made of several of the major stockyards. This included Sioux

> City, St. Paul, Oklahoma City, Louisville, Kentucky, and the land appraisals at that time and the units of livestock were evaluated to determine what the unit allowance would be.
>
> From reviewing those firms' annual reports and the appraisals of the land at those stockyards we came up with the unit cost of five point eight eight cents per unit.
>
> We recommended to the Administrator, the Packers and Stockyards Administration that we adopt the method of allowing a use for land of six cents per unit. We adopted that approximately in 1969 as I recall, and since that date all land values of stockyards have been based on six cents per unit.
>
> The old method of trying to use appraisals, if you appraised it one day and the next day it was outdated, ... with this allowance the stockyard operator knows that he's going to receive six cents for each unit of livestock that he handles. If he wants to utilize less acres of land, he gets a better return for his property. If he wants to spread it out, we don't have to go through the problem of determining the useful area and value of trying to determine the original cost. Most of the markets have no records that will support their original cost of the land.

As a part of Complainant's review of Respondent's operation, Mr. William J. Jones, Regulatory Marketing Specialist, studied the physical plant at Lufkin Livestock Exchange. Having had considerable experience evaluating stockyards and auction markets, Mr. Jones concluded that of the 25 plus acres currently being used by Respondent in its operations, approximately six and one-half acres are used and useful for stockyard purposes. The six and

one-half acres (on which are located virtually all of the improvements) are more than adequate to handle the livestock receipts at Respondent's auction barn. Mr. Jones testified the facility could accommodate, without crowding, up to 3,400 head at one time, whereas sample sales submitted by Respondent to Complainant indicate the largest sample sale in 1971-1972 involved 1,530 head. The mathematical average for the ten-year period from 1962 to 1973 (not including 1969) was 1,154 animal units per sale (Cx-11). From the record evidence it is clear that the six and one-half acres is adequate for Respondent's operation. (Tr. 37, 167-168, 249-272; Cx-9, 10, 11)

Respondent's expert on land appraisal testified that the land in question at the time of the hearing was worth $2,050 per acre. (Tr. 366368; Rx-5) Assuming this valuation is correct, the total value of the six and one-half acres of land used for stockyard purposes would be $13,325. At the established rate of return, 8 percent (No. 15, *supra*), Respondent's allowance for return on land would be $1,066, which is less than a third of the allowance computed using a livestock receipts formula.

17. An allowance of $609.81 for additional depreciation (Fig. 1, L 29) is reasonable.

This amount constitutes the depreciation taken on unloading docks installed by Respondent. It was stipulated that the cost of these facilities should be capitalized and the appropriate depreciation expense taken. (Tr. 37-38, Stipulation 2; See also No. 15, *supra*)

18. It is reasonable to make an allowance for auction market bad debts in the computation of revenue requirements. The reasonable allowance for bad debts for Respondent during the base period was $2,769.89. (Fig. 1, L 30)

Respondent's allowance for bad debts is .0003 times the gross value of livestock sold on commission by Respondent during the base period. The rationale and basis for this formula was explained by Witness Brinckmeyer:

> In 1968 we surveyed the entire auction industry in the United States to determine the bad debt losses for the years 1965 and 1966.
>
> That survey showed that the bad debt losses for those years, two years averaged this .0003 in relation to the [gross] value of livestock sold.
>
> So it was determined that we would take out whatever bad debts were shown and replace them by this allowance based on the experience of the industry, based on the philosophy that if this amount [was] provided for rates each year that over a period of time that should have equaled the amount of bad debts that a prudent management would have at their market.
>
> Again, to see that our figures were still reliable and current, or at least reliable, last year for the [years] 1972 and 1973, bad debt losses have been surveyed for the auction industry, and I don't have the exact figures, but I think in 1972 it was .00019 and in 1973 it was .0002 something.
>
> Both years show, that the average put together, that it would be less than .0003, so we're continuing to use that factor for our allowance for bad debts. (Tr. 169-170)

19. The reasonable allowance for operating margin during the base period was $22,715.20. (Fig. 1, L 33)

Respondent's allowance for operating margin is 40 cents per animal unit times the number of units marketed

(56,788) during the base period. In the *Sioux City* case (9 A.D. 4) it was found that some margin above the actual cost of providing the services should be made to take care of contingencies. Otherwise, unexpected changes in costs or revenues would place an unwarranted burden on the operator during the period it would take him to secure a rate change. Moreover, it was concluded that providing such a margin would obviate frequent changes in tariff schedules.

The Judicial Officer in Sioux City set the margin at 11.95 cents out of average per head revenues of 93.95 cents. (9 A.D. 4 at 109) That approximates the 14-percent of total reasonable expenses formerly used by Complainant. Consistent with Complainant's philosophy to use marketing units wherever possible, a figure of 40 cents per marketing unit has been determined as the reasonable allowance for operating margin.

The validity of that figure has been tested by a study of 244 auction markets across the Nation. Witness Stoddard testified the study showed the old 14-percent method would produce an average per marketing unit margin of .3832 cents, 1.67 cents less than the new method. When this factor is added to the allowance for business getting and maintaining expenses, the result is less than a 1-cent change in the average per head revenue requirement. The operating margin also includes an allowance for income taxes. (Tr. 39-40, 170-172, 274-277; Cx-12)

20. The total reasonable revenue requirement for Respondent during the base period was $184,824.58. (Fig. 1, L 34; Tr. 40, 189, 233-234)

21. Respondent's total revenue derived from selling commissions and yardage during the base period was $214,175.41. (Fig. 1, L 35)

This figure was determined by Complainant from Respondent's books and records. (Tr. 40, 134)

22. During the base period Respondent collected in selling commissions and yardage $29,350.83 in excess of the reasonable revenue requirements for that period. (Fig. 1, L 36; Tr. 40-41)

23. Respondent sought to compare its rates and charges with those of other markets. (Tr. 242-245, 304-316; Rx-1) However, it has been held that comparisons of rates and charges at one market with those at other markets are not proper criteria in the determination of the reasonableness of rates and charges. *Secretary of Agriculture* v. *Norfolk Horse and Mule Commission Sales Company*, 1 A.D. 372, 377 (1942); *Secretary of Agriculture* v. *H. L. Bowman, d/b/a H. L. Bowman Cattle Co.*, 1 A.D. 425 at 429 (1942).

In the case of *St. Joseph Stock Yards Co.* v. *United States*, 58 F.2d 290, 294 (W.D. Missouri, 1932), the company argued that its rates and charges were reasonable since they were not higher than those charged by other stockyard companies. The court pointed out that to hold in accordance with the company's argument would mean that rates everywhere must be the same without regard to differences in the value of properties used in various places and without regard to any other conditions or elements which might affect the cost of rendering the stockyard services.

24. Instead of the rates set forth in Tariff IV (38 F.R. 12143), it is concluded that the rates contained in the order hereinafter proposed are reasonable and nondiscriminatory, and are the rates and charges which Respondent should assess for its services and the use of its facilities.

The proposed rates are those contained in Complainant's Exhibit 8 which are adopted herein. The proposed

rates in paragraph A if applied to the livestock receipts at Respondent's auction market during the base period would produce a revenue comparable or above $184,824.58. (Fig. 1, L 34) Rates for additional services are contained in paragraphs B, C, D, and E of the proposed order. (Tr. 41-43, 57-58; Cx-8)

The per-head-weight schedule proposed herein (as opposed to the valuation type tariff presently in effect) provides for rates that are stable, regardless of price fluctuations, and in turn reflect more accurately and uniformly the cost of the service performed. (Tr. 172-176, 225-232)

Proposed Order

The Respondent shall assess the schedule of rates and charges as set forth below, and shall not, hereafter, publish, demand, or collect any rate or charge for the furnishing of any stockyard service more or less than the rate or charge for the service set forth in such schedule:

A. *REGULAR SELLING-YARDAGE CHARGES*:

Ordinary Cattle:	
Weighing less than 300 lbs.	$ 3.00 Per Head
Weighing 300 lbs. and more	3.50 Per Head
Bulls:	
All bulls 800 lbs. and over	10.00 Per Head
Cows and Calves sold as pairs	5.40 Per Pair
Horses, Ponies, and Mules	6.00 Per Head
Hogs:	
Sows, Boars, Shoats and Feeders	1.00 Per Head
Sow and pigs sold as unit	2.00 Per Unit
Sheep and Goats	1.00 Per Head

B. *RESALE AND NO SALE CHARGES*:

Definitions: (1) Resale charges shall apply on all livestock resold without leaving the market premises.

(2) No-sale charges shall apply when a consignor declares his consignment no-sale on price bid, bids in his consignment, or withdraws the same prior to actual sale.

Charges: One-half (½) of the regular selling and yardage charges shall be assessed on all resales and no-sales.

C. *FEED*:

The charge for all feed sold shall be the average monthly cost F.O.B. the market plus $0.005 per lb., $0.50 per cwt.

D. *VETERINARY SERVICES*:

The schedule of charges on all necessary veterinary services performed by an accredited veterinarian will be at posted uniform per-head rates, pursuant to company agreement with the veterinarian performing such services and does not contain any charges retained by the market.

E. *SPECIAL SALES OR SERVICES*:

Special sales or unusual stockyard services such as are included in featured registered cattle and calf sales, annual 4-H sales, and sales for one consignor sold on other than regular sale days which require special services and handling will be charged for under special arrangements agreed to between the parties prior to the special sales.

This Order shall become effective on the sixth day after service hereof.

Copies hereof shall be served on the parties.

Done at Washington, D.C.

/s/ John A. Campbell
John A. Campbell
Administrative Law Judge

August 25, 1975

APPENDIX D

PACKERS AND STOCKYARDS ACT, 1921

Title III—Stockyards

Sec. 301.[7] When used in this Act—

(*a*) The term "stockyard owner" means any person engaged in the business of conducting or operating a stockyard;

(*b*) The term "stockyard services" means services or facilities furnished at a stockyard in connection with the receiving, buying or selling on a commission basis or otherwise, marketing, feeding, watering, holding, delivery, shipment, weighing, or handling, in commerce, of livestock;

(*c*) The term "market agency" means any person engaged in the business of (1) buying or selling in commerce livestock on a commission basis or (2) furnishing stockyard services; and

(*d*) The term "dealer" means any person, not a market agency, engaged in the business of buying or selling in commerce livestock, either on his own account or as the employee or agent of the vendor or purchaser. (7 U.S.C. 201, P.L. 94-410.)

Sec. 302.[8] *(a)* When used in this title the term "stockyard" means any place, establishment, or facility commonly

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7. Amended by acts of Congress, approved Sept. 2, 1958, and Sept. 13, 1976.

8. Amended by acts of Congress, approved Sept. 2, 1958, and July 31, 1968. Section 2(2) of Public Law 85-909 (Sept. 2, 1958) provide as follows: *"Provided, however,* That nothing herein shall be deemed a definition of the term 'public stockyards' as used in section 15(5) of the Interstate Commerce Act."

known as stockyards, conducted, operated, or managed for profit or nonprofit as a public market for livestock producers, feeders, market agencies, and buyers, consisting of pens, or other inclosures, and their appurtenances, in which live cattle, sheep, swine, horses, mules, or goats are received, held, or kept for sale or shipment in commerce.

(*b*) The Secretary shall from time to time ascertain, after such inquiry as he deems necessary, the stockyards which come within the foregoing definition, and shall give notice thereof to the stockyard owners concerned, and give public notice thereof by posting copies of such notice in the stockyard, and in such other manner as he may determine. After the giving of such notice to the stockyard owner and to the public, the stockyard shall remain subject to the provisions of this title until like notice is given by the Secretary that such stockyard no longer comes within the foregoing definition. (7 U.S.C. 202.)

Sec. 305. All rates or charges made for any stockyard services furnished at a stockyard by a stockyard owner or market agency shall be just, reasonable, and nondiscriminatory, and any unjust, unreasonable, or discriminatory rate or charge is prohibited and declared to be unlawful. (7 U.S.C. 206.)

Sec. 306.[11] *(a)* Within sixty days after the Secretary has given public notice that a stockyard is within the definition of section 302, by posting copies of such notice in the stockyard, the stockyard owner and every market agency at such stockyard shall file with the Secretary, and print and keep open to public inspection at the stockyard, schedules showing all rates and charges for the stockyard services furnished by such person at such stockyard.

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11. Amended by an act of Congress approved Sept. 13, 1976.

If a market agency commences business at the stockyard after the expiration of such sixty days such schedules must be filed before any stockyard services are furnished.

(*b*) Such schedules shall plainly state all such rates and charges in such detail as the Secretary may require, and shall also state any rules or regulations which in any manner change, affect, or determine any part or the aggregate of such rates or charges, or the value of the stockyard services furnished. The Secretary may determine and prescribe the form and manner in which such schedules shall be prepared, arranged, and posted, and may from time to time make such changes in respect thereto as may be found expedient.

(*c*) No changes shall be made in the rates or charges so filed and published, except after ten days' notice to the Secretary and to the public filed and published as aforesaid, which shall plainly state the changes proposed to be made and the time such changes will go into effect; but the Secretary may, for good cause shown, allow changes on less than ten days' notice, or modify the requirements of this section in respect to publishing, posting, and filing of schedules, either in particular instances or by a general order applicable to special or peculiar circumstances or conditions.

(*d*) The Secretary may reject and refuse to file any s[illegible]ule tendered for filing which does not provide and give lawful notice of its effective date, and any schedule so rejected by the Secretary shall be void and its use shall be unlawful.

(*e*) Whenever there is filed with the Secretary any schedule, stating a new rate or charge, or a new regulation or practice affecting any rate or charge, the Secretary may either upon complaint or upon his own initiative

without complaint, at once, and if he so orders without answer or other formal pleading by the person filing such schedule, but upon reasonable notice, enter upon a hearing concerning the lawfulness of such rate, charge, regulation, or practice, and pending such hearing and decision thereon the Secretary, upon filing with such schedule and delivering to the person filing it a statement in writing of his reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, regulation, or practice, but not for a longer period than thirty days beyond the time when it would otherwise go into effect; and after full hearing, whether completed before or after the rate, charge, regulation, or practice goes into effect, the Secretary may make such order with reference thereto as would be proper in a proceeding initiated after it had become effective. If any such hearing can not be concluded within the period of suspension the Secretary may extend the time of suspension for a further period not exceeding thirty days and if the proceeding has not been concluded and an order made at the expiration of such thirty days, the proposed change of rate, charge, regulation, or practice shall go into effect at the end of such period.

(*f*) After the expiration of the sixty days referred to in subdivision (a) no person shall carry on the business of a stockyard owner or market agency unless the rates and charges for the stockyard services furnished at the stockyard have been filed and published in accordance with this section and the orders of the Secretary made thereunder; nor charge, demand, or collect a greater or less or different compensation for such services than the rates and charges specified in the schedules filed and in effect at the time; nor refund or remit in any manner any portion of the rates or charges so specified (but this shall not prohibit a cooperative association of producers

from bona fide returning to its members, on a patronage basis, its excess earnings on their livestock, subject to such regulations as the Secretary may prescribe); nor extend to any person at such stockyard any stockyard services except such as are specified in such schedules.

(*g*) Whoever fails to comply with the provisions of this section or of any regulation or order of the Secretary made thereunder shall be liable to a penalty of not more than $500 for each such offense, and not more than $25 for each day it continues, which shall accrue to the United States and may be recovered in a civil action brought by the United States.

(*h*) Whoever willfully fails to comply with the provisions of this section or of any regulation or order of the Secretary made thereunder shall on conviction be fined not more than $1,000, or imprisoned not more than one year, or both. (7 U.S.C. 207, P.L. 94-410.)

9 CFR CHAPTER 2

§ 203.8 Statement with respect to regulations and practices of stockyard owners and market agencies.

(a) Stockyard services furnished by stockyard owners and market agencies pursuant to a reasonable request must be reasonable and nondiscriminatory. Stockyard owners and market agencies have the statutory right and duty to establish, observe, and enforce regulations and practices, which are not unreasonable or unjustly discriminatory, with respect to the furnishing of stockyard services.

(b) The Packers and Stockyards Administration encourages stockyard owners and market agencies to make innovations and to establish and enforce regulations which foster efficient and competitive livestock markets. Section

201.4 of the regulations under the Packers and Stockyards Act (§ 201.4 of this chapter) emphasizes the importance of self-regulation by the livestock industry. It provides for the "legitimate application or enforcement of any valid bylaw rule or regulation, or requirement of any exchange, association, or other organization, or any other valid law, rule or regulation, or requirement to which any packer, stockyard owner, market agency dealer, or licensee shall be subject which is not inconsistent or in conflict with the act and these regulations."

(c) The livestock industry is in a constant state of transition. Rapid changes in the industry require a continual appraisal by stockyard owners and market agencies of their regulations, practices, facilities, and services to meet the demands of the changing industry and to insure improved, efficient services for market patrons.

(d) Livestock owners today have many alternative methods of buying and selling livestock which were not available at the time the Packers and Stockyards Act became law. Terminal livestock markets and auction markets compete with each other as well as other marketing channels, and stockyard owners and market agencies must continually seek ways to improve services and facilities offered to livestock owners. Subject to reasonable regulation, the right to control and conduct the business of a public stockyard remains in the stockyard company, and the right to impose reasonable requirements on its members remains in the livestock exchanges. The Packers and Stockyards Act, 1921, does not abridge the right of the stockyard owner and livestock exchange to conduct their businesses and to establish and enforce regulations and practices not in conflict with the purposes of the law.

(e) Livestock market owners are not required to obtain a Federal certificate of public convenience and necessity before engaging in the business of operating a stockyard as a stockyard owner and conversely, they are not required to obtain Federal Government approval before they cease operations. The Packers and Stockyards Act does not prohibit a stockyard owner from changing the character of the market business. Nothing in the Act prohibits a stockyard owner from converting his operations from a terminal market to an alternative method of doing business. Nothing in the Act prohibits the stockyard owner from operating the new business alone or in association with other persons, including some or all of the market agencies previously engaged in business at the terminal stockyards.

(f) Market agencies at a terminal livestock market have invested time, resources, and effort in establishing their businesses at the market. As long as a terminal livestock market continues in business as a terminal market, the market agencies at the market cannot be removed arbitrarily or capriciously by the stockyard owner. There must be good and sufficient reasons for any such action. Similarly, the number of market agencies operating at the terminal market may be reduced only if such action is reasonably required to foster and insure an efficient, competitive livestock market.

(g) Whenever a stockyard owner engaged in operating a terminal livestock market elects to make a significant change affecting persons engaged in business at the stockyard, reasonable notice must be given to the public and to all persons engaged in business at the stockyard. The notice should be given as much in advance as possible before the date the stockyard owner proposes to effect any such change. Although there is no legal requirement that stockyard owners consult with appropriate market representatives before deciding on rules or regulations af-

fecting them, the Packers and Stockyards Administration encourages such consultation. (See Hearings before the Subcommittee on Livestock and Grains of the Committee on Agriculture, House of Representatives, 90th Cong., first session, on H.R. 6231, p. 23; and S. Rept. No. 1331, 90th Cong., second session, p. 2). Similarly, the market agencies and dealers should consult with stockyard owners on proposed rules or regulations affecting them or market services. In the event of a complaint, consideration will be given as to whether or not the views of the respective parties were fairly considered by the stockyard owners, market agencies, or dealers. The Packers and Stockyards Administration, wherever possible, will give recognition to the mutual agreements between market agencies or dealers and stockyard owners, provided that such agreements are consistent with the provisions of the Act.

(h) Stockyards no longer have a monopolistic position in the field of livestock marketing. Subject to review by the Secretary, a stockyard owner can deny a person the right to establish a business as a market agency or dealer at the stockyard for good cause. Registration with the Secretary as a market agency or dealer does not automatically require that the stockyard owner shall provide the registrant with facilities to do business on a market. To alleviate future misunderstandings about the privilege of establishing a business at a stockyard, a stockyard owner should publish rules to inform individuals and firms of the requirements for establishing a business at the stockyard.

(i) (1) The Act of July 31, 1968 (Public Law 90-446), added the following paragraph to section 307 of the Packers and Stockyards Act:

It shall be the responsibility and right of every stockyard owner to manage and regulate his stockyard in a

just, reasonable, and nondiscriminatory manner, to prescribe rules and regulations and to require those persons engaging in or attempting to engage in the purchase, sale, or solicitation of livestock at such stockyard to conduct their operations in a manner which will foster, preserve, or insure an efficient, competitive public market. Such rules and regulations shall not prevent a registered market agency or dealer from rendering service on other markets or in occasional and incidental off-market transactions.

(2) Under this legislation, a stockyard owner cannot prohibit a market agency or dealer engaged in business at a stockyard from rendering service at another public stockyard. With respect to business by such a market agency or a dealer in an off-market transaction, i.e., a "country" transaction not at a public stockyard, a complete prohibition would be unlawful. The Act specifically states that a stockyard owner's rules and regulations shall not prevent a market agency or dealer from engaging in "occasional and incidental" off-market transactions. The term "occasional," as defined in dictionaries and as construed in numerous court decisions, means occurring now and then; occurring at irregular intervals; infrequent; according to no fixed or certain scheme. The term "incidental" means not of prime concern; subordinate; only an adjunct to something else; related, collateral or pertinent to; dependent on and following the existence of another and principal thing. It is not possible to establish an exact percentage or frequency test to determine whether a market agency or dealer is engaging in more than "occasional and incidental" off-market transactions. Each case would have to be considered on its own merits applying the commonly accepted meanings stated above.

(3) To limit off-market transactions which are more than "occasional and incidental," the stockyard owner

would have to show that such limitation is necessary to foster, preserve, or insure an efficient, competitive public market. In reviewing such a matter on a case by case basis, the Packers and Stockyards Administration would consider all of the relevant facts and circumstances, such as the number of firms operating at the stockyard; the volume of market and off-market transactions being engaged in by such firms; whether the firms engaging in off-market transactions were deliberately trying to circumvent and weaken the public market; the extent to which such off-market transactions were injuring the market; the marketing alternatives available in the area; the competing elements of the livestock industry in the area; the quantity, type, and nature of the livestock business conducted in the area; and any other economic or statistical evidence relating to the matter. No one factor would be decisive. All relevant circumstances would be considered in order to determine whether the limitation was necessary to foster, preserve, or insure an efficient, competitive public market.

(j) The Packers and Stockyards Administration has the responsibility of giving consideration to the issuance of a complaint whenever it has reason to believe that any stockyard owner or market agency has violated the Act. In the formal administrative proceeding initiated by any such complaint, it is the responsibility of the Judicial Officer of the Department to determine, after full hearing, whether the stockyard owner or market agency has violated the Act.

(k) The Packers and Stockyards Administration does not favor or endorse any one system of livestock marketing over any other system of marketing. The views set forth in this statement regarding converting from one system to another are solely for the purpose of setting forth

our interpretation of the applicable legal provisions inasmuch as questions have arisen with respect to these matters. This statement is for the purpose of setting forth the views of the Packers and Stockyards Administration to guide those persons engaged in business as market agencies or as stockyard owners in establishing, observing, and enforcing regulations and practices in the control and conduct or their business. (Secs. 407, 4, 42 State. 169, 72 Stat. 1750; 7 U.S.C. 228(a). Interprets or applies secs. 304, 307, 312; 42 Stat. 161 et seq., as amended; 7 U.S.C. 205, 208, 213) [30 F.R. 15320, Dec. 11, 1965, as amended at 32 F.R. 7700, May 26, 1967; 35 F.R. 1048, Jan. 27, 1970]

ADMINISTRATIVE PROCEDURE ACT

552. Publication of information, rules, opinions, orders, and public records.—(a) This section applies, according to the provisions thereof, except to the extent that there is involved—

(1) a function of the United States requiring secrecy in the public interest; or

(2) a matter relating solely to the internal management of an agency.

(b) Each agency shall separately state and currently publish in the Federal Register—

(1) descriptions of its central and field organizations, including delegations of final authority by the agency, and the established places at which, and methods whereby, the public may obtain information or make submittals or requests;

(2) statements of the general course and method by which its functions are channeled and determined, includ-

ing the nature and requirements of the formal or informal procedures available and forms and instructions as to the scope and contents of all papers, reports, or examinations; and

(3) substantive rules adopted as authorized by law and statements of general policy or interpretations adopted by the agency for public guidance, except rules addressed to and served on named persons in accordance with law.

A person may not be required to resort to organization or procedure not so published.

(c) Each agency shall publish or, in accordance with published rule, make available to public inspection all final opinions or orders in the adjudication of cases (except those required for good cause to be held confidential and not cited as precedents) and all rules.

(d) Except as otherwise required by statute, matters of official record shall be made available, in accordance with published rule to persons properly and directly concerned, except information held confidential for good cause found. (Sept. 6, 1966, P. L. 89-554, § 1, 80 Stat. 383.)

Prior law.—This section is based on Act June 11, 1946, c. 324, § 3, 60 Stat. 238 (§ 1002 of former Title 5).

553. Rule making.—(a) This section applies, according to the provisions thereof, except to the extent that there is involved—

(1) a military or foreign affairs function of the United States; or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, this subsection does not apply—

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule. (Sept. 6, 1966, P. L. 89-554, § 1, 80 Stat. 383.)

Prior law.—This section is based on Act June 11, 1946, c. 324, § 4, 60 Stat. 238 (§ 1003 of former Title 5).

No. 77-1366

In the Supreme Court of the United States

OCTOBER TERM, 1977

GILES LOWERY STOCKYARDS, INC. D/B/A
LUFKIN LIVESTOCK EXCHANGE, PETITIONER

v.

DEPARTMENT OF AGRICULTURE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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DEPARTMENT OF AGRICULTURE

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MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Petitioner, the operator of a market agency in Lufkin, Texas, that sells livestock at auction for a commission (Pet. App. A6), seeks review of a decision by the Department of Agriculture (Pet. App. A15-A99) that new commission rates petitioner sought to institute were not "just, reasonable, and nondiscriminatory," as required by 7 U.S.C. 206. The Department approved an alternative rate sched-

ule that was greater than petitioner's existing charges but less than the requested increase (see Pet. App. A17, A95-A99).[1] The court of appeals affirmed, holding that the Department's ratemaking schedule assured petitioner a reasonable rate of return, that petitioner had received proper notice of the method the Department proposed to use in determining the reasonableness of petitioner's proposed rates, and that the Department's decision is supported by substantial evidence (565 F.2d 321; Pet. App. A1-A14).

1. Petitioner contends that the Department failed to publish and give adequate notice of the methods it used to calculate the rates petitioner would be permitted to charge (Pet. 9-20). This contention is apparently grounded on both the Administrative Procedure Act, 5 U.S.C. 553 (see Pet. 19-20), and the Freedom of Information Act (FOIA), 5 U.S.C. 552 (a)(1)(D) (see Pet. 12): petitioner maintains that the Department should have established its standards for calculating reasonable rates in a rulemaking procedure rather than in an adjudicatory proceeding. As the court of appeals observed (Pet. App. A10-A11), however, an agency may announce new principles in an adjudicatory proceeding, and the choice between rulemaking and adjudication is a matter of agency discretion. *National Labor Relations Board*

[1] 7 U.S.C. 211 provides that whenever, after full hearing, the Secretary of Agriculture determines that any rates or charges are unjust, unreasonable, or discriminatory, the Secretary may determine and prescribe a just and reasonable rate or charge.

v. *Bell Aerospace Co.*, 416 U.S. 267, 290-294; *Securities & Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194.

Petitioner seeks to distinguish these cases on the ground that the Department had adopted and applied the ratemaking principles approved in the instant case as early as 1970 (Pet. 12-16). Thus, petitioner asserts, the principles were not adopted in either rulemaking or adjudication. But although a number of the theories that the Department formally adopted (for the first time) in this case had been applied on an informal case-by-case basis in previous years, that does not make their formal adoption less appropriate or valid. The principles were carefully considered and developed. They escaped authoritative announcement only because, until the present case, none had been challenged in a contested action. Indeed, because the only reported administrative proceedings involving auction stockyard rates were more than 30 years old, predating major changes in ratemaking theories, and the statutory provision requiring rates to be "just, reasonable, and nondiscriminatory" (7 U.S.C. 206) had never been judicially interpreted in an auction stockyard case, the Department's judicial officer[2] accurately concluded that this was "a case of first impression which will serve as a guide for the Department's rate policy involving about 2,000 auc-

[2] The judicial officer has been delegated the Secretary's final administrative authority to decide ratemaking cases under the Packers and Stockyards Act. 7 C.F.R. 2.35(a).

tion stockyards" (Pet. App. A38-A39).[3] Petitioner has not demonstrated that the Department's adoption of these ratemaking principles in this adjudicatory proceeding was an abuse of its discretion.

It must follow that the Department was not obliged to publish its ratemaking procedures prior to the decision of the judicial officer, and that the procedures used here did not violate the FOIA. Procedures cannot be published before they have been adopted; when procedures are adopted in adjudication, the agency's opinion always will be the first formal publication. In any event, as the court of appeals observed, petitioner had ample actual notice of the method the Department proposed to use in this case (Pet. App. A11):

> The Department informed petitioner's counsel by letter, well in advance of the hearing, of the "method used by the Packers and Stockyards Administration to analyze auction rates." Enclosed with the letter was a 15-page document outlining that method, as well as a financial analysis of Lufkin Livestock for rate purposes. See Exhibit 1, Record (vol. 1); Exhibit 10, Record (vol. 4). Petitioner was thus aware of the ratemaking approach, was aware that the De-

[3] Thus, in the next ratemaking case, the Secretary observed that the *Giles Lowery* decision "sets forth the Department's policy, which is binding on the Department's Administrative Law Judges." *In re Central Arkansas Auction Sale, Inc.*, 36 Agr. Dec. 764, 812 (decided May 6, 1977), affirmed *sub nom. Central Arkansas Auction Sale, Inc.* v. *Bergland*, 570 F. 2d 724 (C.A. 8), petition for a writ of certiorari pending, No. 77-1364.

> partment planned to apply it in this case, and was presented with opportunity to build a case around the method or attack its application.

Because petitioner had actual notice of the Department's proposed procedures, he cannot complain of the fact that they were not published in advance.[4]

2. To the extent that the petition challenges the rates established by the Department, it is answered by the court of appeals (Pet. App. A9):

> A party attacking a prescribed rate schedule must show with clear and convincing proof that the rates are unreasonably low. In the absence of such proof, the courts will not find a fifth amendment violation. *American Toll Bridge Co.* v. *Railroad Comm'n*, 307 U.S. 486, 494-95, 59 S.Ct. 948, 83 L.Ed. 1414 (1939); *FPC* v. *Hope Natural Gas Co., supra*, 320 U.S. at 602, 64 S.Ct. 281. Petitioner has failed to carry this rather heavy burden.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.,
Solicitor General.

MAY 1978.

[4] Actual notice is as effective as published notice to ensure that affected persons are apprised of agency rules. 5 U.S.C. 552(a)(1) provides:

> Except to the extent that a person has actual and timely notice of the terms thereof, a person may not in any manner be required to resort to, or be adversely affected by, a matter required to be published in the Federal Register and not so published.

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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1366

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Petitioner,

VS.

THE U. S. DEPARTMENT OF AGRICULTURE AND THE PACKERS AND STOCKYARDS—AMS,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY MEMORANDUM IN SUPPORT OF THE PETITION

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REPLY MEMORANDUM IN SUPPORT OF THE PETITION

The Packers and Stockyards—AMS and the United States Department of Agriculture state, at pages 3 and 4 of their Memorandum In Opposition:

> "Petitioner seeks to distinguish these cases on the ground that the Department had adopted and applied the ratemaking principles approved in the instant case as early as 1970 (Pet. 12-16). Thus, petitioner asserts, the principles were not adopted in either rulemaking or adjudication. But although a number of the theories that the Department formally adopted (for the first time) in this case had been applied on an informal case-by-case basis in previous years, that does not

make their formal adoption less appropriate or valid. They escaped authoritative announcement only because, until the present case, none had been challenged in a contested action. . . ."

"It must follow that the Department was not obliged to publish its ratemaking procedures prior to the decision of the judicial officer, and that the procedures used here did not violate the FOIA. Procedures cannot be published before they have been adopted; when procedures are adopted in adjudication, the agency's opinion always will be the first formal publication. . . ."

By way of reply to Respondents' Memorandum In Opposition in general, and to the above-quoted material, in particular, Petitioner Giles Lowery Stockyards, Inc. makes the following points:

1. When Agency witness Jack W. Brinckmeyer, Chief of the Rates, Services and Facilities Branch of the Packers and Stockyards—AMS, states, for example, with respect to the computed allowance for the use of land, A119, "We adopted that approximately (in 1968). . .", the simple and specific question is: "Why wasn't it announced to those affected so that they could have a chance to govern their businesses accordingly?" While the Respondents try to divert the Court's attention with a characterization that the Agency's use of its rate analysis methodology was "informally . . . applied", the testimony of Mr. Brinckmeyer, quoted so often in both the Decision of the Judicial Officer and in the Initial Decision of the Administrative Law Judge is definitely that the Agency did in fact *adopt* and *apply* its rate analysis methodology to those regulated without providing the regulated marketing businesses the opportunity to operate in accordance with the Agency's adopted policy.

2. This Court stated in *N.L.R.B.* v. *Bell Aerospace Co. Div. of Textron, Inc.*, 416 U.S. 267, 94 S.Ct. 1757, 40 L.Ed.2d 134 (1974) at 293, 294 (1771):

> And in *N.L.R.B.* v. *Wyman-Gordon Co.*, 394 U.S. 759, 89 S.Ct. 1426, 22 L.Ed.2d 709 (1969), the Court upheld a Board order enforcing an election list requirement first promulgated in an earlier adjudicative proceeding in *Excelsior Underwear, Inc.*, 156 N.L.R.B. 1236 (1966). The plurality opinion of Mr. Justice Fortas, joined by the Chief Justice, Mr. Justice Stewart, and Mr. Justice White, recognized that "adjudicated cases may and do . . . serve as vehicles for the formulation of agency policies, which are applied and announced therein," and that such cases "generally provide a guide to action that the agency may be expected to take in future cases." *N.L.R.B.* v. *Wyman-Gordon Co.*, *supra*, at 765-766, 89 S.Ct. at 1429.

A review of the three leading authorities, *S.E.C.* v. *Chenery Corp.*, 332 U.S. 194, 67 S.Ct. 1575, 91 L.Ed. 1995 (1947); *N.L.R.B.* v. *Wyman-Gordon Co.*, 394 U.S. 759, 89 S.Ct. 1426, 22 L.Ed.2d 709 (1969); and *N.L.R.B.* v. *Bell Aerospace Co. Div. of Textron, Inc.*, 416 U.S. 267, 94 S.Ct. 1757, 40 L.Ed.2d 134 (1974), on the choice of ad hoc litigation vs. rulemaking cannot be squared with the Agency having a key witness (Mr. Jack W. Brinckmeyer), mount the witness stand and under oath in a full hearing in June, 1974, begin to testify about policy (rate analysis methodology) adopted as far back as 1968—six (6) years previously; but never announced to those affected by such policy. And this was done again and again. Hence, the rate analysis methodology was not "applied and announced" in the administrative hearing below. Rather, it was adopted and applied by the Agency in years prior to the hearing below; but, without giving knowledge of its adoption, application, and

interpretation to those regulated. This underscores the extreme importance of Question 1 to the field of administrative law.

3. In summary, as opposed to the concept of the agency's rate analysis methodology being derived from an adjudicatory hearing in 1974, the rate analysis and corresponding dates of implementation are outlined as follows:

A. Obtain Actual Expenses Of The Marketing Business.

B. Obtain Adjusted Expenses By Removing:

1. Expenses irrelevant to market's consignors of livestock.
2. Owners' compensation and salary.
3. Bad debt losses.
4. Business getting and maintaining expenses.

C. Add Allowances For:

* 1. Compensation for working owners (1970) (A59-A61);

* 2. Owners' management (1970) (A61);

* 3. Interest on working capital;

* 4. Business getting and maintaining expenses (A116-A117);

5. Return on buildings and equipment (1969) (A77);

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*Note: The "removals" of Part B are later replaced with "allowances" in Part C, and the marked allowances are based on a computation involving the animal unit concept, with 1969 being the earliest firm date referenced in either the Initial Decision and Order of the Administrative Law Judge, see Appendix "C" beginning at A100, and the Decision and Order of the Judicial Officer, Appendix "B", beginning at A15.

* 6. Use of land (1969) (A124-A125);

7. Bad debts (1968) (A64);

* 8. Operating margin (A128).

D. Obtain Reasonable Revenue Requirement (B + C).

E. Compare Actual Revenue Of The Marketing Business To The Reasonable Revenue Requirement.

Hence, Petitioner prays that its Petition For A Writ Of Certiorari be granted.

Respectfully submitted,

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